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IN THE  
**Supreme Court of the United States**

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October Term, 1982

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THE BOEING COMPANY,  
*Petitioner,*

v.

THE UNITED STATES OF AMERICA,  
*Respondent.*

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**APPENDIX TO PETITION FOR A WRIT OF  
CERTIORARI TO THE UNITED STATES  
COURT OF CLAIMS (NOW MERGED INTO  
THE UNITED STATES COURT OF  
APPEALS FOR THE FEDERAL CIRCUIT)**

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## APPENDICES

*Page*

A. Decision of the Court of Claims .....	A-1
B. Opinion of the Armed Services Board of Contract Appeals (ASBCA) No. 19,224, 77-1 BCA ¶ 12,371 .....	B-1
C. Opinion of the ASBCA on Reconsideration, No. 19,224, 79-1 BCA ¶ 13,708 .....	C-1
D. Order Denying Petition for Rehearing .....	D-1
E. Order Extending Time to File Petition for Writ of Certiorari .....	E-1
F. Text of Constitutional Provisions, Statutes and Regulations Involved .....	F-1
1. Article II .....	F-1
2. 50 U.S.C. App. § 2168 .....	F-2
3. Cost Accounting Standard 403, "Allocation of Home Office Expenses to Segments" .....	F-9
4. CASB March 1973 Statement of Operating Policies, Procedures and Objectives .....	F-21
5. CASB May 1977 Restatement of Objec- tives, Policies and Concepts .....	F-26
6. CASB Interpretation No. 1 to CAS 403 .....	F-35
7. CASB Proposed Amendment to CAS 403 .....	F-38
8. Cost Accounting Standard 418, "Allocation of Direct and Indirect Expenses" .....	F-45
9. Defense Procurement Circular Number 99, of May 4, 1972 .....	F-68



**APPENDIX A**  
**The BOEING COMPANY**

**v.**

**The UNITED STATES**

**No. 268-79C.**

**United States Court of Claims.**

**June 2, 1982.**

Government contractor appealed from decision of the Armed Services Board of Contract Appeals denying its claim for certain costs incurred under cost-plus fixed fee contract. On cross motions for summary judgment, the Court of Claims, Davis, J., held that contractor's allocating home office tax expenses to its various segments for purposes of determining costs incurred under cost-plus fixed fee contract by distributing taxes in proportion to number of employees in each segment was improper under cost accounting standard requiring direct allocation of tax costs on basis of beneficial or causal relationship between supporting and receiving activities.

Government's motion granted, contractor's cross motion denied, and petition dismissed.

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Stephen G. Anderson, with whom was Asst. Atty. Gen., J. Paul McGrath, Washington, D. C., for defendant.

Before COWEN, Senior Judge, and DAVIS and BENNETT, Judges.

**ON CROSS-MOTIONS FOR  
SUMMARY JUDGMENT**

**DAVIS, Judge:**

This case presents a contest over the amount owed to plaintiff, The Boeing Company (Boeing), by the defendant

for certain costs incurred under a cost-plus-fixed fee contract between the Air Force and Boeing. The more precise issue is whether claimant properly allocated home office tax expenses to its various divisions. We affirm the decision of the Armed Services Board of Contract Appeals (ASBCA), denying plaintiff's claim.

In September 1972, Boeing was awarded a research and development contract by the Air Force. Payment was to be on a cost-plus-fixed fee basis; costs were generally defined in the agreement; and the fixed fee set. The contract included a "Cost Accounting Standards" clause which required that the contractor comply with all cost accounting standards in effect on the date of the award of the particular contract and any standards effective at the time future government contracts were entered into by that contractor during this contract's performance period.<sup>1</sup> Cost Accounting Standards were promulgated by the Cost Accounting Standards Board (CASB) pursuant to 50 U.S.C.App. § 2168 (1976).

The present dispute centers on Cost Accounting Standard 403 (CAS 403), 4 C.F.R. § 403 (1981), which was included in this contract as of January 1, 1974. It provides the method by which government contractors are to allocate home office expenses to different segments of a corporate organization. The home office expenses now involved are several types of state and local taxes: real property; personal property; sales; use;

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1. "COST ACCOUNTING STANDARDS (1972 JUL)"

(a) Unless the Cost Accounting Standards Board has prescribed rules or regulations exempting the Contractor or this contract from standards, rules, and regulations promulgated pursuant to 50 U.S.C.App. 2168 (Public Law 91-379, August 15, 1970), the Contractor, in connection with this contract shall:

\* \* \* \* \*

(3) Comply with all Cost Accounting Standards in effect on the date of awards of this contract or if the Contractor has submitted cost or pricing data, on the date of final agreement on price as shown on the Contractor's signed certificate of current cost or pricing data. The Contractor shall also comply with any Cost Accounting Standard which hereafter becomes applicable to a contract or subcontract of the Contractor. Such compliance shall be required prospectively from the date of applicability to such contract or subcontract. \* \* \*

business and occupation; and fuel and vehicle taxes. The controversy focusses [sic] first on the meaning of CAS 403 as applied to these expenses of Boeing, and then on the validity of the standard if its meaning is other than Boeing claims.

# I

Boeing manufactures aircraft and other products for commercial and governmental use. Its Washington State business, that part of its operation with which we are concerned in this proceeding, was conducted through a corporate headquarters in Seattle and several operating divisions (segments) and subsidiaries. Boeing operates several Seattle-area plants, each of which is assigned to one division for administrative and maintenance purposes. This is usually the segment that predominantly uses the facility, most often the Commercial or Aerospace division, although most of the plants are utilized by all of the divisions. Control of a plant shifts along with usage—if another division becomes the predominant user of the facility, it assumes control over it.

Each Boeing division that controls the property, manufactures the goods or makes the sale subject to taxation, initially determines and records the amount of tax costs it incurs. Sales taxes are paid by each division and the other expenses are reported to the headquarters in the State of Washington and paid by the main office. The latter expenses are then allocated back to each segment and further allocated to particular contracts.

The specific question concerns Boeing's method of allocating its Washington state and local tax expenses between its various divisions. It has distributed these costs to each segment in proportion to the number of employees working in each segment; this is known as the employee base or headcount allocation system. The contracting officer disallowed part of plaintiff's claimed tax costs because they were derived by the headcount method which he held does not comply with CAS 403. According to the contracting officer, CAS 403 mandates the use of an assessment base method of tax cost

allocation. Under this method, costs are allocated by using the base which was used to measure the particular tax. For example, because property taxes are assessed on the value of property, segment A would be allocated the property taxes attributable to the property it controls.<sup>2</sup>

This contracting officer's decision was upheld in comprehensive opinions by the Armed Services Board of Contract Appeals. *The Boeing Co.*, ASBCA No. 19,224, 77-1 BCA ¶ 12,371, confirmed on reconsideration, *The Boeing Company*, ASBCA No. 19,224, 79-1 BCA ¶ 13,708. That tribunal held that CAS 403 requires that home office expenses be identified with and allocated to particular segments, if possible. It found that the tax costs before us could be specifically identified by use of an assessment base method of allocation.<sup>3</sup> Boeing's headcount method was rejected as not complying with the requirement that costs be specifically identified with a division to the maximum extent practical.

Plaintiff appeals to this court and both parties have moved for summary judgment.

## II

The initial problem is the proper meaning of CAS 403. Boeing claims that the ASBCA's interpretation is inconsistent with this court's prior rulings in *Boeing Co. v. United States*, 202 Ct.Cl. 315, 480 F.2d 854 (1973) (*Boeing I*) and *Lockheed Aircraft Corp. v. United States*, 179 Ct.Cl.

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2. The tax bases involved here are: (1) real and personal property taxes (including commercial work-in-process inventory) which are based on assessed value of the property; (2) sales taxes—based on each purchase of goods or services not intended for resale; (3) use taxes—based on tangible personal property manufactured by the claimant; (4) business and occupation taxes—based on gross proceeds of sales or value of products (Renton, one of the taxing localities, bases its business and occupation tax on the number of employees working in Renton; it has been treated separately throughout this proceeding. See Part VI, *infra*); (5) fuel and vehicle taxes—based on market value.
  3. As we have said, the Renton business and occupation tax was treated differently by the ASBCA. See Part VI, *infra*.

545, 375 F.2d 786 (1967); that the CASB did not intend to overrule those earlier decisions and did not reject the "broad benefits" test they enunciated.<sup>4</sup> We are also told, in this connection, that CAS 403 utilizes the same allocation concepts as the former regulation, Armed Services Procurement Regulation (ASPR) § 15-201 *et seq.* In Boeing's view, the new standard does not mandate use of the assessment base method but is flexible in permitting any approach which measures benefits to the receiving segments from the tax expenditures.

A. The fundamental flaw in this analysis is its failure to recognize the importance of the new provision in CAS 403 requiring that costs be allocated directly to segments. The portion of the new standard that is controlling in this case is 403.40. It provides for a three tier process for allocating home office expenses. CAS 403.40(a)(1), 4 C.F.R. § 403.40(a)(1)(1981).<sup>5</sup>

A prime requirement is direct allocation of these expenses "to the maximum extent practical." If direct allocation of the individual expenses is impractical, they must be grouped into homogeneous pools and allocated according to criteria prescribed in 403.40(b). Under that subsection, central payments made by the home office are to be allocated directly to the individual segments if they can be so identified. 4

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4. The headcount method was upheld as a proper measure of benefits, under the prior regulation, in *Boeing I* and *Lockheed*.

5. "§ 403.40 *Fundamental requirement.*

(a)(1) Home office expenses shall be allocated on the basis of the beneficial or causal relationship between supporting and receiving activities. *Such expenses shall be allocated directly to segments to the maximum extent practical.* Expenses not directly allocated, if significant in amount and in relation to total home office expenses, shall be grouped in logical and homogeneous expense pools and allocated pursuant to paragraph (b) of this section. Such allocations shall minimize to the extent practical the amount of expenses which may be categorized as residual (those of managing the organization as a whole). These residual expenses shall be allocated pursuant to paragraph (c) of this section. \* \* \* [emphasis added]



C.F.R. § 403.40(b)(4)(1981).<sup>6</sup> Otherwise, they are to be distributed "using an allocation base representative of the factors on which the total payment is based." *Id.* Expenses not directly allocable and not subject to grouping in pools are considered residual expenses and are allocated "by means of a base representative of the total activity of [each segment] \* \* \*" 4 C.F.R. § 403.40(c) (1981). Allocation as a residual expense is to be minimized. 4 C.F.R. § 403.40(a)(1) (1981).

The primary question, then, is whether the two opposed accounting methods in dispute—the headcount method and the assessment base method—specifically identify tax expenses with individual segments. The parties agree that the assessment base method does directly allocate the tax expenses to individual Boeing divisions. Transcript at 580, Testimony of Dr. Howard Wright, June 3, 1975. See *The Boeing Co.*, ASBCA No. 19,224, 77-1 BCA ¶ 12,371 at 59,891; *The Boeing Co.*, ASBCA No. 19,224, 79-1 BCA ¶ 13,708 at 67,236 (reconsideration decision). Plaintiff also concedes that the headcount method is not a means of direct allocation but a surrogate measure of business activity. By the literal terms of the new accounting standard, therefore, the assessment base system is permissible and the headcount approach seems improper.

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6. "(b) The following subparagraphs provide criteria for allocation of groups of home office expenses.

\* \* \* \* \*

(4) *Central payments or accruals.* Central payments or accruals which are made by a home office on behalf of its segments shall be allocated directly to segments to the extent that all such payments or accruals of a given type or class can be identified specifically with individual segments. Central payments or accruals are those which but for the existence of a number of segments would be accrued or paid by the individual segments. Common examples include centrally paid or accrued pension costs, group insurance costs, State and local income taxes and franchise taxes, and payrolls paid by a home office on behalf of its segments. Any such types of payments or accruals which cannot be identified specifically with individual segments shall be allocated to benefited segments using an allocation base representative of the factors on which the total payment is based." [emphasis added]

Contrary to Boeing, this standard of direct allocation is a new requirement. The regulation construed in *Lockheed* and *Boeing I*, old ASPR § 15-201, -202, -203, -205, 32 C.F.R. § 15.201 *et seq.* (1974), did not call for specific identification for tax expenses. The old ASPR contained a direct identification provision in 15-202(a). However, that provision applied only to direct costs, defined as those "which can be identified specifically with a particular cost objective." 32 C.F.R. § 15.202(a) (1974). Tax costs are considered indirect, defined as those "which, because of \* \* \* [their] incurrence for common or joint objectives, \* \* \* [are] not readily subject to treatment as a direct cost." 32 C.F.R. § 15.203(a) (1974). Both of our prior decisions treated the taxes there involved as indirect costs and did not apply the direct identification section. *Lockheed*, 179 Ct.Cl. at 558, 564, 375 F.2d at 793, 797; *Boeing*, 202 Ct.Cl. at 320, 321, 480 F.2d at 857; *The Boeing Co.*, ASBCA No. 11866, 69-2 BCA ¶ 7898 at 36,749, 36,752-754. But the indirect cost section in the former ASPR did not require specific identification—merely compliance with "generally accepted accounting principles," 15.203(d), and distribution based on the "benefits accruing to the several cost objectives." 15.203(c). In contrast, as we have pointed out, CAS 403 generally mandates direct allocation of home office expenses whether considered as direct or as indirect. 4 C.F.R. § 403.40(a)(1), (b)(4). That requirement is both new and important.

Boeing rests secondarily on the provision of the new accounting standard limiting application of the specific identification requirement to circumstances where it is "practical." See 4 C.F.R. § 403.40(a)(1); note 5, *supra*. The company defines practical, not as economically feasible, but as capable of "fair and accurate cost accounting." It then defines fair accounting as being able to measure benefit to the segments from community services and, since it concludes that an assessment basis does not accurately measure such benefit, it reasons that that formula is an improper allocation method. We do not agree.

First, tax costs fall under 403.40(b)(4), note 6, *supra*, not (a)(1), as indirect costs requiring groupings into logical and

homogeneous pools prior to allocation to segments. See generally 32 C.F.R. § 15.203(b) (1974). The language of 403.40(b)(4) does not contain the limiting phrase, "to the maximum extent practical," found in (a)(1).

Second, assuming that the language in (b)(4) requiring specific identification "to the extent that all such payments or accruals \* \* \* can be [so] identified," includes the practicality limitation, we agree with the ASBCA that "practical" in its common usage means no more than economically feasible. As interpreted by plaintiff, the term would be merely a superfluous repetition of the explicit requirement in other parts of CAS 403 that the allocation system for home office expenses be based on a beneficial or causal relationship (see note 5, *supra*)—a requirement which we discuss next.

CAS 403 requires, in addition to direct allocation, that home office expenses be "allocated on the basis of the beneficial or causal relationship between supporting and receiving activities." 403.40(a)(1), 4 C.F.R. § 403.40(a)(1) (1981); see note 5, *supra*. Plaintiff equates this with the old ASPR standard in that both (it is said) emphasize the importance of measuring the beneficial relationship between the expenses and the corporate segments and both contain a causal relationship element. Boeing then reads cause, in the context of tax expenses, as the need for the community services financed by the taxes, and benefit as the provision of the services, *e.g.*, police and fire protection, by the community (this is sometimes called the "broad benefits" test).

We cannot, however, accept this "broad benefits" test as the sole controlling element under CAS 403. It is important at once to recognize, as Boeing does not, that neither *Boeing I* nor *Lockheed* rejected the assessment base as failing to meet the criterion of the prior regulation. All the court did there was to indicate that the assessment basis method was not the only permissible system under the then ASPR, but that the headcount method was permissible at that time. There was no analysis of, or ruling on, the benefit aspects of direct assessment. *Lockheed*, 179 Ct.Cl. at 553-54, 555, 565, 375 F.2d at 791-92, 798; *Boeing*, 202 Ct.Cl. at 320, 480



F.2d at 857; *The Boeing Co.*, 69-2 BCA, at 36,752-753; 70-1 BCA, at 38,552 (distinguishing *General Dynamics* which upheld assessment basis as meeting the benefits test). See *General Dynamics*, ASBCA No. 13,868, 69-2 BCA ¶ 8044.

Moreover, the prior ASPR interpreted in those earlier cases did not contain a requirement of *causal* relationship. The language cited by Boeing, "with due consideration of the reasons for incurring the costs," 32 C.F.R. § 15.203(b) (1974), concerned formation of the logical cost groupings, not how those costs were to be allocated after being placed in pools.

The turning point in this case is, as the ASBCA held, that the assessment base method, incorporated into CAS 403, does measure a beneficial or causal relationship, as broadly conceived in our prior cases, between home office tax expenses and the receiving segments. The ASBCA recognized that, while the need for tax-funded public services is a cause of the taxes and that the receipt of the services is a benefit to the divisions, these are not the only benefits or causes. 77-1 BCA, ¶ 12,371 at 59,891. Other causes of these taxes include the control over the property, or the purchase or business transaction which results in the tax levied. These causes squarely support, and relate to, the assessment base method.<sup>7</sup>

As for a beneficial relationship, claimant argues too far in saying that the broad benefits test precludes use of an assessment basis. If benefit is defined broadly, and it is, see *Lockheed*, 179 Ct.Cl. at 561-62, 375 F.2d at 795-96, then it is satisfied by the assessment system. The benefit here, commensurate with the causal relationship discussed above, is not the benefit of receiving tax-paid services but the advantages to the segments of having the home office pay their

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7. It is significant that CAS 403.40(a)(1), note 5 *supra*, puts the requirement for a beneficial or causal relationship in the disjunctive, requiring proof of a causal relationship or beneficial relationship, but not necessarily both. For that reason, though we find a beneficial relationship, we are not persuaded by Boeing's insistence that a beneficial relationship is always required even if a causal relationship exists.

taxes, including reducing the administrative burden and preventing tax liens and seizures.<sup>8</sup>

The broad benefit test does not require a one-to-one relationship between benefit and tax cost. *Lockheed*, 179 Ct.Cl. at 564-64, 375 F.2d at 797. In fact, the only evidence before the ASBCA on this issue indicated that there is no statistical correlation between headcount and tax expenditures (number of employees in a locality as compared to the amount of taxes paid). 77-1 BCA ¶ 12,371 at 59,878-879. Plaintiff offers no example where a specific identification/causal allocation does not also include some concept of broad and general benefit.

Support for the inference that the CASB believed that an assessment base approach, as embodied in CAS 403, would comply with the beneficial or causal relationship requirement is found in the illustrative examples given in CAS 403.60. That subsection lists as acceptable bases for allocating central payments or accruals (and, specifically, state and local income taxes and franchise taxes): "Any base or method which results in an allocation that equals or approximates a segment's proportionate share of the tax imposed by the jurisdiction in which the segment does business, as measured by the same factors used to determine taxable income for that jurisdiction." 4 C.F.R. § 403.60 (1981). These examples are illustrative, and were not intended to be exclusive.<sup>9</sup> Nevertheless, the example indicates that the CASB

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8. The fact that tax deficiencies can result in the seizure of any property, not merely that included in the assessment base, is not relevant. We deal in any case with taxes paid by the home office, and the method of allocation is immaterial. The benefit accrues to the segment because there is a home office paying the expense; if there was no home office to pay, the lien would be only on the segment's property under either the assessment or the headcount basis.
  9. Plaintiff repeatedly argues that CAS 403 should be interpreted flexibly and that, even if the assessment base method does comply with the standard, it is not the only lawful means of allocating costs. True, the standard does not necessarily mandate any particular allocation method. The choice we must make here, however, is between assessment base and headcount, and we reject the latter because it does not adequately identify costs with segments.

considered that an assessment base approach, the one used in the illustration,<sup>10</sup> satisfies that board's notion of the beneficial or causal relationship test. *See* 403.60(c).

B. Claimant also makes some minor challenges to the conclusion that assessment base allocation is called for by CAS 403 with respect to taxes. It is contended that 403.40(a)(1) requires all taxes to be placed in a single pool but that assessment base does not allow for this kind of pooling and this does not comply with CAS 403. The ASBCA correctly answered this argument in its determination that the argument's "fallacy derives from the appellant's conception of all taxes being for the same purpose, *i.e.* the funding of community services and so all includable in one pool with one (head count) base. We perceive no difficulty in treating each tax with a different assessment base separately and directly allocating those which may be specifically identified thereby with an individual segment and that which is not so identifiable being distributed on a base representative of the factors on which it is based." 77-1 BCA ¶ 12,371 at 59,896.

Boeing also claims that the assessment base method violates the anti-double counting provision in 402.20, 4 C.F.R. § 402.20 (1981). Again, the ASBCA properly pointed out that "a direct allocation of a particular tax cost to a segment on the basis of the tax assessment base would not involve double counting so long as the same tax cost was not retained in a pool and again allocated to the segment from that pool." 79-1 BCA ¶ 13,708 at 67,239.

### III

Assuming plaintiff can challenge contract provisions it has agreed to, compare *Sandnes' Sons, Inc. v. United States*, 199 Ct.Cl. 107, 113, 462 F.2d 1388, 1392 (1972) with *Rough Diamond Co. v. United States*, 173 Ct.Cl. 15, 351 F.2d 636 (1965), *cert. denied*, 383 U.S. 957, 86 S.Ct. 1221, 16 L.Ed.2d 300 (1966), we now explore Boeing's challenge that the

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10. A base which uses "the same factors (which are) used to determine taxable income for that jurisdiction" is an assessment base measure.

interpretation we have just upheld in Part II, *supra*, violates the authorizing legislation.

As a general rule, "Where there is a 'broad congressional grant of administrative authority to prescribe rules and regulations to effectuate the provisions of the Act \* \* \* our scope of review is limited \* \* \* [t]his court \* \* \* can invalidate such a regulation only if it clearly contradicts the terms or purposes of the statutes.'" *Boeing*, 202 Ct.Cl. at 340, 480 F.2d at 868-69 (1973). The CASB was thus permitted to adopt reasonable regulations not clearly disallowed by a statute. *See Boeing*, 202 Ct.Cl. at 339, 480 F.2d at 868.

In this light, we have to reject the contentions that the assessment base method infringes the uniformity and cost accuracy requirements of the Defense Production Act Amendments of 1970, 50 U.S.C. § 2168 (1976), and the policy of encouraging competition among potential contractors embodied in the Armed Services Procurement Act of 1947, 10 U.S.C. §§ 2301 *et seq.* (1976) (ASPA).

As to the alleged failure of the assessment basis to result in accurate cost accounting, that point is, for the most part, a reprise of plaintiff's earlier claim that the method does not comport with CAS 403. As we have said, while the "causal or beneficial relationship" measured by CAS 403 differs from that used in *Lockheed*, it is still a permissible measure. Our holding in *Boeing I* sustaining a regulation precluding reimbursement to government contractors for commercial inventory tax expenses indicates that allocation schemes which do not fully and meticulously measure tax-funded community services comply with statutory requirements of accuracy and fairness. The CASB is given by its statute broad authority to promulgate regulations; the only limitation is that the regulations "achieve uniformity and consistency." 50 U.S.C.App. § 2168(g) (1976). CAS 403 achieves this by treating tax expenditures in the same way, and does not exceed the CASB's authority.

Plaintiff's second statutory argument, that CAS 403 results in differing treatment of contractors in different states allegedly reducing their competitiveness, was

expressly rejected by this court in *Boeing I* as a ground for voiding a comparable cost regulation. 202 Ct.Cl. at 340-41, 480 F.2d at 869.<sup>11</sup> The court in *Boeing I* likewise rejected any Fifth Amendment claim arising out of the same argument of disparate treatment. 202 Ct.Cl. at 342-43, 480 F.2d at 870.

#### IV

Another assault on the validity of CAS 403 concerns the manner in which it was promulgated. The assertion is that the CASB failed to comply with the notice and comment requirements of the Cost Accounting Standards Act. See 50 U.S.C.App. § 2168(i)(A) (1976).<sup>12</sup> We do not find this to be so.

One contention is that the CASB failed to indicate more clearly that the new cost standard would require use of the assessment base allocation system for tax expenses, and would differ from the prior method upheld in *Boeing I* and *Lockheed*. But the statute requires prior disclosure of the

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11. The court said that the governing statutes cannot "be construed to mean that Government procurement policies must be dependent upon a meticulous study of the variable cost situations of contractors operating in all 50 states resulting from the differences in the tax structures of the states and their political subdivisions, and how such structures may conceivably (taking into consideration the contractors' accounting systems) affect the contractors' costs on its Government contracts."

12. "(i)(A) Prior to the promulgation under this section of rules, regulations, cost-accounting standards, and modifications thereof, notice of the action proposed to be taken, including a description of the terms and substance thereof, shall be published in the Federal Register. All parties affected thereby shall be afforded a period of not less than thirty days after such publication in which to submit their views and comments with respect to the action proposed to be taken. After full consideration of the views and comments so submitted the Board may promulgate rules, regulations, cost-accounting standards, and modifications thereof which shall have the full force and effect of law and shall become effective not later than the start of the second fiscal quarter beginning after the expiration of not less than thirty days after publication in the Federal Register."

See also 4 C.F.R. § 301.5 (1981).



terms and substance of the proposed rule, not an analysis of its ramifications. The fact that the notice need not even state with detailed specificity all of the rules which may later be adopted is indicative of the less than full explanation required to satisfy the regulatory procedures. See *California Citizens Band Assn. v. United States*, 375 F.2d 43, 48 (9th Cir.), cert. denied, 389 U.S. 844, 88 S.Ct. 96, 19 L.Ed.2d 112 (1967). Aside from the language of the income tax example in 403.60, which will next be discussed, the rule (i.e. CAS 403) was adopted as proposed and the plaintiff had sufficient information from which it could have gleaned the change in the new standard from the prior ASPR.<sup>13</sup>

The only modification from the draft to the final rule was in the income tax example in 403.60. The income tax illustrative base was changed from one allocating expenses based on profit or loss of each segment to one based on the "same factors used to determine taxable income for that jurisdiction." Boeing complains that this was a substantial change which should have been first issued as a proposal subject to comment for a period of thirty days. That argument makes far too much of very little.

For one thing, the change in the income tax example did not affect application of the assessment base method. That system is required because of the direct identification provision for indirect costs—a provision which was already in the draft. The income tax illustration does not determine the proper allocation method but is only instructive as to the intent of the CASB with respect to what is a "beneficial

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13. Plaintiff cites several exhibits which, it claims, show that the CASB knew it was proposing a drastic change in allocation methods. None of these indicates any expected drastic change from the proposal to the final draft. The statements suggest only that republication might be beneficial, not necessary, and they are unclear as to why it would be beneficial and what section they are referring to. Moreover, they suggest that interested parties, like Boeing, were already apprised of the potential change in measurement since the CASB explanations were responses to complaints by or probably known to those interested parties.

As far as we can determine, no more than a few government contractors were interested in maintaining the headcount method at issue in this case.

or causal" relationship.<sup>14</sup> And for that purpose it was helpful but not decisive.

Even if the change in the illustration was really material to this case, it was within the range of permissible alterations after a period of administrative comment. The particular change was made in response to critical comments by a majority of those commenting on this point. 4 C.F.R. § 403, Preamble A, Part 7 (1981). The fact that changes were possible should not have been unexpected since the CASB specifically requested comments on the income tax example. 37 Fed.Reg. 13,064 (1972). A new notice is not required when an agency "adopts the suggestions of interested parties." *Ethyl Corp. v. EPA*, 541 F.2d 1, 48 (D.C.Cir.), cert. denied, 426 U.S. 941, 96 S.Ct. 96, 49 L.Ed.2d 394 (1976). Accord, *Northwest Airlines, Inc. v. Goldschmidt*, 645 F.2d 1309, 1319-20 (8th Cir. 1981); *Trans-Pacific Freight v. FMC*, 650 F.2d 1235, 1248 (D.C.Cir. 1980).

## V.

Boeing's final charge is that the CASB was unconstitutionally constituted and its acts void, including the promulgation of cost accounting standards. The difficulty plaintiff sees is that the members of the CASB were not appointed by the President with the advice and consent of the Senate, as said to be required by the Appointments Clause of the Constitution, Art. II, § 2, cl. 2.<sup>15</sup>

The argument for this position is by no means insubstantial, but we need not consider or rule upon it. Even

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14. Plaintiff could not have been misled by the change. It admits that the originally proposed illustration also used an assessment base approach. Plaintiff's Reply Brief, at 28. If that was Boeing's belief then, taking into account the specific identification provision already in the proposal, plaintiff should have been aware that its headcount method was probably no longer to be permitted.

15. The Cost Accounting Standards Board was composed of five members, the Comptroller General and four persons appointed by him. Only the Comptroller was appointed by the President and confirmed by the Senate, and that was only as the Comptroller, not for the position of Chairman of the CASB.

if we were to accept plaintiff's full constitutional contention, we could not hold Boeing entitled to the monetary relief it seeks in this case.<sup>16</sup> The reason is that the Department of Defense itself adopted CAS 403 and that Department had the independent authority to accept the standard on its own. Under the same general authority which grounded adoption of the Armed Services Procurement Regulations, the Defense Department could adopt or accept any permissible cost standard, no matter who the proposer. The Department did this in Defense Procurement Circular 99, establishing the relevant CASB standards (including CAS 403) as the Department's own. The Department was not deprived of its authority to adopt these standards because it may have assumed mistakenly (if plaintiff is right as to the legal ineffectiveness of the CASB and its productions) that the law compelled it to do so. Whatever the departmental motivation, that agency permissibly established the standard and intended to do so. Even if the Cost Accounting Standards Act was invalid, the law would still not limit the sources from which the Defense Department could find and pick its cost standards—so long as those standards were substantively proper (as we have held *supra*).<sup>17</sup>

If it be necessary—which we do not think—that the CASB and its standards must have some sort of official standing in themselves, the principle of the *de facto* officer prevents in this case the past acts of the CASB from being held invalid. See *Buckley v. Valeo*, 424 U.S. 1, 142-43, 96 S.Ct. 612, 693, 46 L.Ed.2d 659 (1976). As in that case (concerning the Federal Election Commission), the past acts of the CASB would be “accorded *de facto* validity.” Equity and practicality demand that result. The number of contracts which would need to be altered, the amount of moneys involved, and the agreement by the contractors to the CAS

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16. Of course, we can grant only monetary relief and are not authorized to enter a declaratory judgment on the validity of the CASB as it was composed.

17. There is no doubt, for instance, that Defense could accept the proposals of a committee of private expert accountants which had no official status whatever.



403 standards would justify nonretrospective application of any current ruling of unconstitutionality of the method of appointment of the CASB members.

## VI

Throughout this litigation the parties have treated the Renton business and occupation tax separately. Defendant concedes that the Renton tax cannot be identified directly with Boeing's segments because it is expressed on a sliding scale, the tax per employee declining as the total number of employees increases, based on the number of Boeing employees in Renton. Plaintiff argues that its headcount method should apply, allocating the Renton tax according to the total number of employees of each segment as a percentage of the total work force.

The ASBCA, pursuant to 403.40(b)(4), allocated the tax between the segments according to the proportion of the number of employees of that segment in Renton as a percentage of the total Renton Boeing work force. This method is consistent with the standard's requirement that "payments or accruals which cannot be identified directly with individual segments shall be allocated to benefited segments using an allocation base representative of the factors on which the total payment is based." 403.40(b)(4). This result harmonizes with our analysis in this opinion, and we affirm the ASBCA's conclusion on this point, as well as on the other taxes now before us.

## *Conclusion*

For the foregoing reasons, we grant defendant's motion for summary judgment, deny plaintiff's cross-motion, and dismiss the petition.<sup>18</sup>

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18. Defendant's motion to strike the affidavit of Harold F. Olsen is denied.

## **APPENDIX B**

### **ARMED SERVICES BOARD OF CONTRACT APPEALS**

Appeal of —	)	
The Boeing Company	)	
Under Contract No.	)	ASBCA No. 19224
F33-657-73-C-0257	)	

#### **APPEARANCES FOR THE APPELLANT:**

Harold F. Olsen, Esq.  
Graham H. Fernald, Esq.  
Perkins, Coie, Stone, Olsen  
and Williams  
Seattle, Washington

#### **APPEARANCES FOR THE GOVERNMENT:**

Colonel Benjamin H. Rosker,  
USAF  
Chief Trial Attorney  
William S. Merrell, Esq.  
Trial Attorney

### **OPINION BY ADMINISTRATIVE JUDGE NICHOLAS**

The appellant appeals under the disputes clause of a cost plus fixed fee contract from the disallowance of \$972 of appellant's January and February 1974 tax costs allocated to the contract. (The dollar amount here in dispute is token; the principles being litigated affect Boeing's many, and often large, Government contracts.) The disallowance was premised on Defense Contract Audit Agency Resident Auditor's report of 17 August 1973 concluding that as of 1 January 1974 the appellant's "headcount" method of allocating certain taxes to its various Seattle area organizations would not be in compliance with Cost Accounting Standard (hereinafter CAS) 403 applicable to the contract on 1 January 1974, and that as a result of the use of that allocation method Government contracts would be substantially overcharged.

The appellant contends that its allocation method effects a distribution of the cost consistent with the "benefits" theory, has been upheld by this Board against a Government

challenge in *Boeing Company*, ASBCA No. 11866, 69-2 BCA par. 7898 prior to the promulgation of CAS 403 and is consistent with CAS 403 properly interpreted.

The Government contends that CAS 403.40(b)(4) requires the costs to be "allocated directly" to the various Seattle area organizations if they can be "identified specifically" with those organizations and that they may be so identified by the "assessment base" of the various taxes involved.

The appellant does not question that most of the taxes may in a sense be identified with the organizations in this manner but insists that to do so does not effect a proper distribution according to the benefits theory.

Although raised at an early stage of these proceedings, issues of the validity of CAS 403 and the propriety of the procedure by which it was promulgated were not litigated in these proceedings.

## FINDINGS OF FACT

### The Contract

The contract under which this dispute arises is a cost plus fixed fee research and development contract. It was awarded on 12 September 1972 by the United States Air Force, Air Force Systems Command, Aeronautical Systems Division, Wright-Patterson Air Force Base, Ohio to the Boeing Company (Strategic Missile Systems Division, SRAM Program), Seattle, Washington. The contract required the appellant to conduct studies, analyses, simulations and tests for integrating the Short Range Attack Missile (SRAM) with the B-1 aircraft and its associated avionics system; and to provide data as set forth. It was not contemplated that any equipment would be developed or delivered under the contract. The contractor's effort was to be performed from 1 October 1972 through 31 July 1975.

The contract did not indicate where the contractor effort was to be performed except that certain engineering support to be provided to the Weapon System Contractor (WSC) was to be provided "on site." The record does not show where that "site" was.

The contract contained among the General Provisions the Disputes clause (1958 JAN) (ASPR 7-103.12(a)), Changes clause (1967 APR) (ASPR 7-404.1), Allowable Cost, Fixed Fee, and Payment clause (1972 May) (ASPR 7-203.4(a)), and Cost Accounting Standards clause (1972 JUL) (see appendix).

The Allowable Cost, Fixed Fee and Payments clause provides that the Government will pay the contractor for the performance of the contract the costs of performance determined to be allowable in accordance with "(A) Part 2 of Section XV of the Armed Services Procurement Regulation as in effect on the date of this contract; and (B) the terms of this contract; . . ." The pertinent provisions of that regulation as stipulated by the parties are those set forth in ASPR dated 1 July 1974.

The Cost Accounting Standards clause required the contractor to comply with all Cost Accounting Standards in effect on the date of award of this contract and such as later become applicable to a contract of the contractor. Compliance with such post-award requirements was to be prospective from the date they became applicable to the contract. The parties stipulate that CAS 403 became applicable to this contract on 1 January 1974.

Cost Accounting Standard 403.40(b)(4), below, is the controlling section:

*"(4) Central payments or accruals.* Central payments or accruals which are made by a home office on behalf of its segments shall be allocated directly to segments to the extent that all such payments or accruals of a given type or class can be identified specifically with individual segments. Central payments or accruals are those which but for the existence of a number of segments would be accrued or paid by the individual segments. Common examples include centrally paid or accrued pension costs, group insurance costs, State and local income taxes and franchise taxes, and payrolls paid by a home office on behalf of its segments. Any such types of payments or accruals which cannot be identified specifically with individual segments shall be allocated to benefited

segments using an allocation base representative of the factors on which the total payment is based."

Other pertinent provisions of applicable Cost Accounting Standards are set forth in the appendix hereto.

### **The Taxes**

The notice of disallowance of \$972 as a cost of this contract concludes that the appellant's method of allocating certain of its tax cost to its subordinate organizations is improper. The taxes involved are:

1. Real Property
2. Personal Property
3. Sales
4. Use
5. Business and Occupation
6. Fuel and Vehicle

It is the method of allocating these taxes that is in dispute.

### **The Real Property Tax.**

The Revised Code of Washington (RCW) subjects all non-exempt real property to an ad valorem tax. (RCW 84.36.005) The property is assessed by the county assessor (RCW 84.40.040) and the tax is paid to the county treasurer (RCW 84.56.010). The tax is a lien on the property and on any real property of the owner wherever located. (RCW 84.60.020) The tax levy rates vary with the location of the property. The County Real Estate Tax Statement indicates the distribution of the tax dollars to State, county, city, school, port, sewer and water, fire, library and other districts. (Gov't. Exh. 9, Tab B)

### **Personal Property Tax.**

All non-exempt personal property is subject to an ad valorem tax. (RCW 84.36.005) The property is assessed by the county assessor (Govt. Exh. 10, Tab C) based on an affidavit of the owner (Govt. Exh. 10, Tab B). The tax is paid to the county treasurer. The tax is a lien on all personal property of the owner and may be extended to all of the owner's real property. (RCW 84.60.020; 84.60.040) The tax.



levy rate varies with the location of the property. The County Personal Property Tax Statement indicates the distribution of the tax dollars to State, county, city, school, library, sewer and water, fire and other districts. (Govt. Exh. 10, Tab D)

### **Sales and Use Taxes.**

During the period here applicable, a tax of 4.5% of the selling price was imposed on each sale in the State. (RCW 82.08.020) The tax is paid by the purchaser and collected by the seller at the time of sale. (RCW 82.08.050) Counties and cities could, and did, impose an additional sales tax not to exceed 0.5%. King County imposed a 0.3% "Metro Sales Tax" for mass transit purposes. (Govt. Exh. 8, Tab A, App. Exh. 19, p. 35)

A complementary "Use Tax" of 4.5% of the value of tangible personal property is levied upon the use of such property in the State. (RCW 82.12.020) Property upon which a sales tax is paid in the State is not subject to the use tax. A credit is allowed for a sales or use tax paid on the property to another State. (RCW 82.12.035) As with sales taxes, counties and cities may and do impose an additional 0.5% use tax and King County imposes an additional .3% "Metro Use Tax."

These taxes are reported to the State on a "Combined Excise Tax Return" which reflects not only the State sales and use taxes but separately the "Local City and/or County Sales and Use Tax" itemized by city and/or county and the Metro Sales and Use Tax. (Govt. Exh. 8, Tab A) These taxes are paid to the State Department of Revenue.

### **Business and Occupation (B&O) Taxes.**

The State of Washington imposes an annual tax for the act or privilege of engaging in business activities within the State. (RCW 82.04.220) The tax rate depends upon the nature of the business activity. (RCW 92.04.230-290) For example, the rate on "Retailing" is 0.44%, on "Services" 1%, Manufacturing 0.44%. The tax is measured by applying the appropriate rate to either the value of products, gross

proceeds of sales or gross income of the business, as the case may be. (RCW 82.04.220) The tax is reported to the State on the Combined Excise Tax Return and is paid to the State Department of Revenue. (Govt. Exh. 5 and Exh. 8, Tab A)

The cities of Everett, Seattle and Renton impose an additional B&O (business license) tax. The Everett base is based upon the sum of direct labor, indirect labor and 65% of that total labor cost as non-labor costs. This base is the product of an agreement between the city and the appellant. (Govt. Exh. 4, Tab A, 11-4.3.48.4) The Seattle tax is based upon the gross receipts base utilized for the State B&O tax less that which is attributed to out-of-city activities. (Govt. Exh. 4, Tab A, 11-4.3.48.2) The Renton tax is based on a graduated scale upon the number of a firm's employees who perform any or all of their duties within the city. (Govt. Exh. 4, Tab A, 11-4.3.48.3; Tr. 99)

#### **Fuel and Vehicle Taxes.**

The State imposes a tax on the purchase and consumption of fuel. The State also imposes a motor vehicle license tax.

#### **The Appellant's Organization**

The appellant company is a Delaware corporation. It is in the business of designing, developing, and manufacturing numerous products and services including military and commercial aircraft, missiles, space vehicles, hydrofoil boats, ground transportation equipment, management and maintenance services, computer data processing and related parts and services. (Stip. par. 1)

The appellant owns and operates manufacturing plants and other facilities located in the States of Washington and Kansas and the Commonwealth of Pennsylvania and conducts business in numerous other states and foreign countries. (Stip. par. 2)

As of 17 August 1974, the appellant employed approximately 76,500 persons of which about 54,300 were located in the State of Washington. The latter figure includes

about 2,700 employed in a wholly-owned subsidiary, Boeing Computer Services, Inc. (Stip. par. 2 and 4)

Boeing's physical resources in the State of Washington are located in the cities of Everett, Seattle, Renton, Kent and Auburn all within a 30 mile radius of the center point of the City of Seattle. (Stip. par. 3 and 5) Many of the employees working at each of these various locations reside at other locations within the same general area. (Stip. par. 5) For example while the Everett plant in the northern area had 6,190 plant workers, only 3,166 lived in that area; while the Auburn plant in the southern area had 5,808 plant workers, only 2,473 lived in that area. Each of those two plants had only a relatively small number of employees who resided in the other's area. The plants in the cities of Seattle, Renton, and Kent, which are closer together, have a work force more markedly composed of residents of other areas. For example, while the Seattle plant had 19,956 workers, only 7,695 of those resided west of Lake Washington; 4,459 resided east of Lake Washington, the area where the Renton plant is located; 4,233 resided south of the Lake where the Kent plant is located; 2,225 resided even farther south where the Auburn plant is located. (App. Exh. 9)

The Boeing Company conducts its business through a corporate headquarters, four operating divisions (Boeing Aerospace Company, Boeing Commercial Airplane Company, Boeing Vertol Company, and the Wichita Division), one service and operating subsidiary corporation (Boeing Computer Services, Inc.), one service division (the Seattle Services Division) which provides support services to the operating organizations in the State of Washington, and several special purpose subsidiary corporations. (Stip. par. 4)

The corporate headquarters consists of about 200 people. The headquarters delegates to the operating division the management responsibility to pursue, acquire and conduct business in specific product lines or programs. Operating plans are prepared annually by each division and include targets and goals as to business acquisitions and sales. The divisions function relatively autonomously in their responsibility to perform what they are committed to



perform. The headquarters maintains surveillance and provides guidance. For example, the headquarters chief financial officer promulgates in "The Boeing Company Manual," finance instructions describing how each subordinate organization is to treat the various taxes with which this appeal is concerned. (Tr. 307, 308; Stip. par. 4; App. Exh. 2; Govt. Exh. 4)

The two operating divisions in Washington State have the following programs and products assigned for management:

**BOEING  
COMMERCIAL  
AIRPLANE COMPANY**

707/727/737/DIVISION

707-320B/C

Advanced 737/200/C/OC

Advanced 727-200

747 DIVISION

747-100/200B/C/F

747SR

747SP

**FABRICATION  
DIVISION**

Fabrication Support for  
all Boeing Divisions  
Centralized Procurement

7X7 PROGRAM

**BOEING AEROSPACE  
COMPANY**

**SPACE AND STRATEGIC  
SYSTEMS GROUP**

Minuteman Program

Short-Range Attack

Missile

Air-Launched Cruise

Missile

**MILITARY SYSTEMS  
GROUP**

Advanced Airborne

Command Post

Airborne Warning and

Control System

B-1 Avionics

YC-14 Program

747 Advanced

Tanker/Cargo

SAC Automated Total

Information Network

**ARMY SYSTEMS  
DIVISION**

Roland Program

Signature of Fragmented

Tanks

**BOEING AEROSPACE  
COMPANY (continued)**

**NAVAL SYSTEMS  
DIVISION**

**Petrol Missile Hydrofoil  
Jetfuel Program**

**Miscellaneous Programs**

**The services and support divisions have the following missions:**

**BOEING COMPUTER  
SERVICES, INC.**

**Computer Services to  
Boeing Operating  
Organizations  
Computer Support  
Services for Business,  
Scientific and  
Government Use  
National Consulting  
Service**

**SEATTLE SERVICES  
DIVISION**

**Security/Fire Protection  
Transportation  
Employee Services  
Payroll/Timekeeping  
Medical Services  
Administrative Services  
Special Services**

**Although the Boeing Aerospace Company (BAC) and Boeing Commercial Airplane Company (BCAC) are each designated "company" they are not separately-incorporated legal entities. They enter contracts in The Boeing Company name. (Tr. 319)**

**Boeing Computer Services (BCS) was incorporated as a wholly-owned subsidiary on 1 January 1971. Other divisions and the corporate headquarters obtain their computer services from BCS by contract. BCS was formed for the purpose of achieving greater economics and efficiencies in the use of computing resources through centralization of management responsibility and for the active pursuit of the sale of computing services to customers other than The Boeing Company. BCS was organized as a wholly-owned subsidiary to demonstrate a commitment by The Boeing Company to the commercial computer data processing market. (Stip. par. 4)**

Seattle Services Division (SSD) was formed on 1 July 1971 for the purpose of achieving better management control and economies of operations of an array of nonproduct-oriented support services which formerly had been performed by corporate headquarters and other divisions in the State of Washington. (Stip. par. 4)

The numerous divisions of the company perform their respective missions at the various sites in Washington State. At most sites all divisions will utilize some part of the facility. At most sites the utilization by one division, invariably one of the two operating companies, predominates at any moment in time. For example as of 15 September 1974 the plant utilization was as follows:

<u>Plant</u>	<u>Total Sq. Ft.</u> <u>(000)</u>	<u>BAC</u>	<u>BCAC</u>	<u>Other</u>
Plant II (Seattle)	3,278	1,887	1,099	292
Boeing Field (Seattle)	654	117	507	30
Thompson Tract (Seattle)	265	90	166	9
Development Center (Seattle)	1,577	1,173	355	49
Renton Plant	5,241	402	4,661	178
Kent Space Center	1,335	1,104	0	231
Kent Spares Spt. Cntr.	778	0	540	238
Auburn Plant	2,092	26	2,049	17
Everett Plant	3,346	33	3,241	72

(App. Exh. 5)

The headquarters normally assigns to either the BAC or the BCAC the responsibility for the administration, maintenance and repair of each of the foregoing facilities. The assignment is based upon which of the two is the predominant user of the particular facility. As of 1 January 1974 the BAC was assigned this responsibility for the Seattle Plant II, the Seattle Developmental Center and the Kent Space Center. The Boeing Field, Thompson Tract, Renton, Auburn and Everett plants were assigned to BCAC. (Stip. par. 5)

The parties stipulated the divisions' 1974 assignment of facilities management responsibility and the divisions' actual utilization as follows:

**ASSIGNMENT AND USE OF SEATTLE  
AREA FACILITIES BY BOEING  
SEGMENTS**

**AVERAGE SQUARE FOOTAGE UTILIZED IN 1974**

<u>USER/OCCUPANTS</u>	<u>SPACE ASSIGNED TO</u>	
	<u>BAC</u>	<u>BCAC</u>
	<u>Sq. Ft. (000)</u>	<u>Sq. Ft. (000)</u>
HEADQUARTERS	75	3
BCAC	1,481	10,801
BAC	4,128	619
SSD	267	392
BCS	206	108
<b>TOTALS</b>	<b><u>6,157</u></b>	<b><u>11,923</u></b>

Division custodianship of the various plants, being based on predominant use, has changed from time to time. The two large facilities in the Seattle area, for instance, have changed as follows:

	<u>Plant II</u>		<u>Development Center</u>	
	<u>% Utilized</u>		<u>% Utilization</u>	
	<u>BAC</u>	<u>BCAC</u>	<u>BAC</u>	<u>BCAC</u>
1966	12	85*	68*	32
1967	8	88*	43*	57
1968	7	88*	25	75*
1969	3	91*	22	77*
1970	2	85*	16	83*
1971	36*	50	5	93*
1972	53*	39	16	82*
1973	55*	31	51*	46
1974	60*	33	75*	23

\* Custodian (App. Exh. 5)

The appellant treats its personnel, in the Seattle area especially, as a single manpower resource. (Tr. 325, 349) Transfers of employees from one division to another are frequent and administratively handled by the Seattle Services Division by simply changing the organization

number on the employee's record and the employee's badge number. (Tr. 349) Voluntary transfers are encouraged by publishing the positions available in the various divisions and locations. Transfers in and out of Boeing Computer Service, Inc. seem to be treated on the same basis. (App. Exh. 8) While the record demonstrates in absolute terms the number of transfers effected in and out of the various divisions over a 10 year period, it does not show what percentage of the employees assigned to any one division has remained stable over a period of time. (App. Exh. 7)

### **The Services Financed by Taxes and Their Relationship to the Appellant**

The appellant commissioned Mr. William B. Pilkey, Executive Vice President, Washington State Research Council, to prepare

**"A STUDY of the Services Provided by the State and Local Governments in the State of Washington; How They Are Financed; the Extent to Which These Services Benefit the Conduct of Business in the State by the Boeing Company; and How the Benefits from These Services Relate to the Types and Amounts of Taxes Paid by Boeing with Respect Thereto." (App. Exh. 19)**

Mr. Pilkey is well versed in the operation of Washington State and local Governments and particularly their fiscal management. (Tr. 473, App. Exh. 18) He is not a cost accountant, nor familiar with ASPR cost principles or Cost Accounting Standards. Though his study utilizes the word "benefit" often, he does not purport to use the word as a cost accountant would understand it from the ASPR cost principles or the CAS. (Tr. 524) The study was prepared with the assistance of Boeing Company personnel. For instance, Appendix B is entitled "A Report Prepared by the Boeing Company of Examples of Governmental Services Provided to the Company by State and Local Governments in the State of Washington."

The study summarizes the "Services Provided by State and Local Governments" as follows:

**"Services Provided by State and Local Governments**

The principal services provided to the residents and businesses located in Washington by all state and local governments combined, in descending order of magnitude of use of funds (excluding debt service and financial administration), are as follows:

1. Education, which is provided through the public schools, community colleges and four year colleges, and universities;
2. Human resources, including public assistance, medical assistance, correctional rehabilitation, mental hospitals, care of the retarded and other services, employment security and workmen's compensation.
3. Transportation, consisting primarily of street and highway construction and maintenance;
4. Sanitation, including sewerage, refuse collection and disposal and street cleaning;
5. Police protection, including protection of life and property and traffic regulation by county sheriff, city police departments and the State Patrol;
6. Parks and recreation;
7. General control through legislative and judicial agencies and executive officials;
8. Fire protection, including fire fighting and fire prevention activities;
9. All other state and local government functions, including building maintenance, libraries and general government.

"In 1974 the first two items listed above, i.e., education and human resources, accounted for approximately 53 and 15 percent respectively, or a total of 68 percent of all direct tax-supported expenditures for state and local government and 81 percent of all such expenditures at the state government level alone. Transportation and protective services account for an additional 16 percent of total state and local expenditures."

The report summarizes the "Sources of Financing Such Services" as follows:



### **"Sources of Financing Such Services**

The sources of tax funds for state and local governments, in descending order of magnitude of gross collections, are:

1. Real and personal property;
2. Sales and use;
3. Business and occupation (gross receipts) including payments in lieu of taxes by publicly owned utility districts;
4. Motor vehicle fuel;
5. Cigarette, tobacco and liquor;
6. Excise on motor vehicles;
7. Inheritance and gift;
8. All other taxes.

"Some taxes, such as the school property tax levy and the motor vehicle fuels tax, are imposed to finance specific services. However, most taxes are not earmarked for specific purposes, but rather are available to finance a broad range of governmental services."

Part IV of the study "analyzes the services provided by the state and local governments to which Boeing pays taxes, both directly and indirectly. The purpose of this analysis is to determine whether correlative relationships exist between the taxes Boeing pays to the state and local governments in Washington and the services that are performed by these governments, *i.e.*, whether and to what extent Boeing in the conduct of its business derives benefit from these services." It presents a number of tables showing the taxes paid by appellant and their distribution to the State and the various counties, cities, school districts, road districts, and port districts.

Appendix B to the study addresses the various ways in which the appellant benefits from the services provided by the State and local Governments. It characterizes some of the benefits as very direct, direct, less direct and indirect, although no benefit is quantified and some explicitly recognized as not quantifiable.

The quality of the elementary and secondary schools is of "direct value" to appellant's recruiting efforts and its ability to retain good people. Pre-employment training at Puget Sound area community colleges and vocational schools is a "very direct benefit" when qualified potential hires are not available in the local market. Of "less direct" value is the opportunity for continuing education.

Public health and hospitals provide a "direct benefit" in sanitation inspection, water sampling for chemicals and bacteria. Alcohol education and treatment programs, mental health clinics, university industrial hygiene services, and occupational health services and others are of "somewhat more indirect benefit (through company employees)." Most other social and health services provide an "indirect benefit" through the benefit to its employees and the assurance of an environment in which the company can operate successfully.

Streets, roads and highway are of benefit to the company which uses them in its business and through its employees who use them for movement from home to work. When the company's needs require it, it has made presentations to the affected city, county or state which have resulted in road improvements being made.

Boeing receives the benefit of the services of police, fire and regulatory bodies. For some fire department services Boeing pays an extra fee, e.g. \$10,000 to Port of Moses Lake and \$18,000 to Seattle Fire Department for service south of the Seattle city limits. The establishment by the City of Kent of a fire station close to the company's newly-activated plant there was viewed as a benefit in allowing the company to avoid locating firefighting manpower at the facility.

Airports operated by King County and Snohomish County, the City of Renton and the Port of Seattle are utilized by the appellant. In each case it pays fees for use or leases a portion. "The benefits Boeing receives from its use of these publicly-owned facilities are reflected in reduced cost of operation of not having to own them itself."

Library services provide "Direct Benefits to Boeing" in that it avoids the purchase, housing and maintenance costs



for lesser-used business and technical information required in the conduct of its business. The benefit is calculated to be approximately \$50,000 annually.

Park and recreation facilities are utilized by Boeing employees and the employee recreation clubs it supports.

The results of the analysis undertaken in Part VI of the study are summarized as follows:

"As can be seen from the foregoing, the number of types of taxes Boeing pays with respect to the business it conducts in Washington State is not great. Likewise, the taxing authorities to which such taxes are paid directly are small in number. Due to the fact that the state and its counties in practice act as collecting agents for other local governments, and many transfers of funds take place, it is a somewhat complex matter to attempt to trace tax payments to using agencies and services provided by such agencies. However, it can be done.

"Table 24 on page 87 is a graphic presentation that shows the flow of taxes paid by Boeing through the collecting agencies to the using agencies and some of the principal services provided by each using agency.

"The benefits received by any one corporate taxpayer, including The Boeing Company, in relation to the taxpayer's contribution of taxes paid will vary depending on his needs and circumstances. Some benefits flow back to the taxpayer very directly, such as the services provided by policemen or firemen in response to a call by the taxpayer for assistance. Others are more indirect, such as the public schools where the benefit to a corporate taxpayer may be found only in the improved services rendered to contented employees. Nevertheless acceptable public schools may be of vital importance, such as where the absence of proper schooling might even result in problems of securing an adequate work force.

"The benefits received by Boeing from governmental services and functions, either directly or indirectly or through benefits received by its employees, are not subject to specific quantifiable measurement in most instances.



With regard to the relationship between the taxes appellant pays and the services it receives, the study states:

"No precise or direct cause and effect relationship between the services that benefit Boeing and the taxes paid by Boeing can be quantified. However, there seems to be little question but that there is a very direct correlation in the legislative process that takes place at all levels in government in arriving at the programs to be undertaken and the taxes to be levied to finance such programs. The effect of such programs and their costs on The Boeing Company are constantly being weighed by the lawmakers involved. We therefore must assume that the taxes Boeing pays are, in fact, its fair share of the costs to the local governments for the services provided as determined by the lawmakers in whom these responsibilities are vested.

"It also seems clear that the incidence of each tax Boeing pays, i.e., the real and personal property used to measure property taxes assessed, the property and services purchased and consumed which are used to measure the sales and use taxes paid, the gross receipts from sales of products and services used to measure the B & O taxes, and the fuel consumed used to measure fuel taxes, are not valid indications of either the services provided by the state and local governments to all taxpayers or the benefit received by Boeing from such services. This is particularly so if you attempt to equate any one tax to any specific service. Rather, they are merely the legislative selected bases for measuring the tax revenues to be collected to finance the services that the individuals and businesses of the state have indicated they want and need. The services to be provided are related to the needs and wants of the people while the tax bases selected are related only remotely to those needs."

#### **Taxes Paid and Their Relationship to Appellant's Head Count**

The Government introduced two studies of the relationship of Boeing taxes to the number of employees working in the Seattle area and to the number of employees

residing in the various cities and counties in the area. (Govt. Exhs. 12 and 13) They were explained by Mr. Harold Yarnell.

Mr. Yarnell is a regional supervisory auditor with the DCAA, San Francisco regional office. He has been with that agency for nearly 10 years; has been a CPA for 22 years. He has been a tax auditor for the State of California, managed his own tax and auditing practice and taught accounting at the college level. (Tr. 173-176)

His study of the relationship of taxes paid to employee head count, covering the years 1968-1973, compared the average total Seattle area head count for each of those years with the taxes per head as follows:

	<u>Head Count</u>	<u>Total Taxes</u> <u>(000)</u>	<u>Taxes Per Head</u>
1968	98090	\$46,924	\$ 480
1969	85883	45,760	530
1970	56495	53,325	940
1971	39516	44,424	1,120
1972	40147	33,251	830
1973	49280	31,256	630

Mr. Yarnell's statistical analysis of these data led him to the conclusion that there is no significant correlation between the head count and the taxes per head. So far as there is any relationship at all, it is inverse in that as head count decreases, taxes per head increase. (Tr. 292) The study, however, did not take into account the fact that the tax dollars paid in successive years suffered from inflation. (Tr. 301)

Mr. Yarnell's study of the relationship between taxes paid and the residence of Boeing's employees utilized data for the year 1973. The following reflects the results of his study:

## B-20

### "Taxes Per Boeing Employee By Residence Locations In Tax Jurisdictions Year 1973

<u>Geographical Locations</u>	<u>Number of Employees by Residence</u>	<u>Total Taxes</u>	<u>Taxes Per Employee</u>
<u>King County</u>			
Seattle	11562	\$ 6,989,183	\$ 604
Renton	6495	6,277,227	966
Kent	3977	3,329,606	837
Auburn	3645	3,886,968	1,066
Bellevue-Kirkland (1)	5360	2,115,659	395
South King County (1)	8926	3,532,097	396
All Other	3400	1,340,666	394
Total County	43365	\$27,471,405	633
<u>Snohomish County</u>			
Everett-Mukilteo	1234	\$ 6,494,993	\$5,263
Edmonds-Lynwood (1)	1650	1,255,445	761
All Other	734	561,052	764
Total County	3618	\$ 8,311,490	\$2,297
<u>All Other Counties</u>	3208	\$ 1,145,025	\$ 357
Total Company- State of Washington	50191	\$36,927,921	\$ 736

(1) These areas were included in "all other \$427" on the residence map schedule.

The study led Mr. Yarnell to the conclusion that there was no correlation whatever between the taxes paid to a locality and the number of Boeing employees residing in that locality. (Tr. 295)

### The Appellant's Treatment of Taxes

The Boeing Company corporate headquarters promulgates Finance Instructions concerning the "charging of taxes" generally and Finance Tax Instructions concerning particular taxes. (Govt. Exh. 4)



The Finance Instruction "covers the charging of the cost of taxes incurred by groups, divisions and branches of The Boeing Company and by domestic operating subsidiaries . . ." These groups, etc. are referred to as segments of the company. "Taxes incurred" is stated to mean "incurred on an 'as (to be) assessed basis.'" Boeing Computer Service, Inc. is one of the domestic operating subsidiaries.

The cost of all State, county and municipal taxes incurred in the State of Washington is charged to a "tax redistribution work order" (administered by headquarters' finance staff) and subsequently allocated (as overhead) to segments of the company based on head count of employees located in the State of Washington.

The cost of other than Washington State taxes incurred by segments of the Company is charged to "work orders or to an overhead account." If the tax is incurred as a result of efforts substantially all expended on one program, the charge is made to a work order for allocation to that program. All other taxes incurred by the segment are charged to one of its overhead accounts for further allocation by it.

The general instruction includes a listing of the "Type of Tax and Taxing Jurisdiction", the "Factors/Functions Generating Tax" and columns in which to indicate whether the particular tax is to be charged to the headquarters' redistribution work order, a production work order or an overhead account. Taxes generated by personal property, real property and special tooling are to be charged to an overhead account or a production work order except the real and personal property taxes in Washington State, which are chargeable to the headquarters' redistribution work order. The sales and use taxes generated by the purchase or use of tangible personal property or services are likewise normally charged to an overhead account or production work order except that those tax costs incurred by the Washington, D.C. office, the New York office and in Washington State are chargeable to the redistribution work order. Business and occupation taxes also are for the most part charged to an overhead account or production work order save only those incurred in Washington State which

are charged to the redistribution work order. The only other taxes charged to the headquarters' redistribution work order are the Washington State fuel taxes and motor vehicle licenses.

The Finance Tax Instructions (Govt. Exh. 4) pertain to the sales and use tax, the B&O tax, Seattle, Everett and Renton business license taxes, and the Washington motor vehicle fuel tax and special fuel tax. Except for the Renton Business license tax, the instructions inform the operating organizations how they should accumulate the various tax costs and report them to the corporate headquarters. Under Boeing's organization with a small headquarters all transactions are recorded at the source in the divisions and the accounting staffs in those divisions' operating companies maintain the records and the data necessary for tax purposes. (Tr. 425, 426) The instructions concerning the B&O tax, for example, state:

"Each division or branch operating within the State of Washington will:

A. Each month accrue the Washington Business and Occupation tax liability on its own books on all taxable billings and gross receipts [etc.]

B. . . .  
The Office of the Director of Taxes will record the tax liability in the corporate books based on the division and branch reports, and will charge the offsetting amounts to the divisions to clear their tax liability accounts. . . .

The Office of the Director of Taxes will prepare and file the Washington excise tax return and pay the tax to the Washington State Department of Revenue. . . ."

The instruction for the Renton business license tax is treated somewhat differently. The tax is based upon the number of employees working in the City of Renton. (Tr. 99) The Headquarters Office of the Director of Taxes obtains such head count figures from the corporate personnel office and determines the tax, files the return and pays the tax.

The data necessary for the appellant to pay its personal property tax is similarly collected by the Office of the

Director of Taxes from the companies, divisions, and branches which exercise financial accounting control of the property. (Govt. Exh. 10, Tab A) On the basis of the data he thus collects, the Director of Taxes pays the personal property tax for the appellant. Likewise, on the basis of this data it is possible to determine how much of the overall tax is traceable to the personal property in the custody of or on the books of account of the individual segment. (Tr. 89-99, Govt. Exh. 3)

The costs associated with particular parcels of real estate are recorded on the books of account of either BAC or BCAC, whichever segment is assigned administrative responsibility for the particular parcel of real estate in the State of Washington. (Tr. 84) The headquarters pays the tax based on the county assessor's assessment and levy. (Tr. 86)

The foregoing methods of accumulating data for the payment of taxes permit by "simple arithmetic" the taxes' relationship to segments to be "very easily identified on the assessment base." (Tr. 430)

The appellant does not attempt to measure or trace or allocate on the basis of assessment. It would not, in appellant's view, measure or identify on the basis of benefit, or any other sensible relationship, the benefits received by the operating companies. (Tr. 430) Rather, it accumulates these tax costs in a headquarters account for distribution to the segments. The distribution of the taxes thus pooled to each of the four segments, BAC, BCAC, SSD and BCS, is effected on the basis of the percentage that its head count is of the total head count of the four segments. (Tr. 374) This is the allocation base contested here.

Each segment, of course, further distributes the amount thus charged against it. For example, the amount charged to the BCAC is recorded in an employee service cost pool. The costs in that pool are then further allocated between a manufacturing prime pool and an engineering prime pool. The distribution is effected on the basis of the percentage of each, manufacturing and engineering personnel (head count), to the total manufacturing and engineering personnel.

These pools contain a considerable number of other costs and are the last resting place for indirect costs before being allocated to final cost objectives (contracts). In the BCAC the amount in the manufacturing pool is then distributed to the various final cost objectives on the basis of direct labor hours. (Tr. 379-381)

The Boeing Aerospace Company's subsequent distribution of the taxes charged to it is somewhat more complex, being made to a series of product pools and resource pools. A product pool accumulates costs for each of the major products, for example the naval systems product line. The resource pools cover manufacturing resources and engineering resources. The allocation between these pools is again based upon the relative number of employees on a product or a resource compared to the total number of employees in the segment. (Tr. 385-6) From these pools the allocation to the final cost objective is based upon a rate per hour of direct labor chargeable to the final cost objective. (Tr. 387)

The taxes initially allocated to the service segments, i.e. SSD and BCS, on the head count basis, to a large extent through their further distributions, end up in the operating segments' costs ultimately charged against their final cost objectives. The exception is so much of the tax allocated to Boeing Computer Service as is distributed to the cost of services provided to others than its parent. Otherwise the tax cost allocated to a service segment is reallocated by it, in the case of the SSD to the print shop cost center or in the case of BCS to the cost of the machine center and other cost centers and overhead pools within the segments. (Tr. 374) The basis for distribution to these cost centers is not evident in the record. From these cost centers the costs, by then commingled with other costs, are allocated to final cost objectives on the basis of the cost per printed page, for example, or use of the machine center, or when such bases are not available, head count is often used as a surrogate. (Tr. 374)

## **The Development of Cost Accounting Standards**

In March 1973 the Cost Accounting Standards Board (CAS Board) distributed a Statement of Operating Policies Procedures and Objectives (App. Exh. 22) to improve general understanding of its fundamental objectives and concepts. While not intended to be all encompassing it is useful as an aid to understanding the cost accounting standards (CAS) promulgated by the CAS Board.

The CAS Board's stated primary goal is to achieve an increased degree of uniformity in accounting practices among Government contractors even while recognizing the impossibility of attaining absolute uniformity because of the problems inherent in defining the "like circumstances" under which contractor's accounting practices should be alike.

The CAS Board deals with the concept of allocability because of its effect on the ascertainment of contract cost. Allocability "... results from a relationship between a cost and a cost objective such that the cost objective appropriately bears all or a portion of the cost." To be charged appropriately with all or part of a cost, "a cost objective should cause or be an intended beneficiary of the cost." (Id., p. 2) It notes that "as an ideal, each item of cost should be assigned to the cost objective which was intended to benefit from the resource represented by the cost or, alternatively, which caused incurrence of the cost." (Id., p. 17)

Beyond its statement of objectives and basic concepts, the CAS Board described its process of developing the standards. This process begins with extensive background research including review of pertinent court and board of contract appeals cases. Thereafter, a preliminary version of a standard is distributed to scores of Government agencies, industry and professional associations, individual contractors, and others knowledgeable in cost accounting. After their views are given consideration, an exposure draft of a proposed standard is published in the Federal Register for comment. After comments are received and considered, the standard is again published in the Federal Register. The standard does not become effective until after a certain period of time



elapses during which time the Congress has the opportunity by concurrent resolution to reject it. If not thus rejected, the standards have the effect of law.

In January 1972 the CASB distributed a draft CAS 403 to industry for discussion purposes only. (App. Supp. Rule 4, Doc. Tab A) The transmittal letter to the Council of Defense and Space Industry Associations (CODSIA) indicated that "the Standard has been written to emphasize the importance of cost allocation based on the beneficial and/or causal relationships between home offices and divisions, subdivisions or other segments of a company." The appellant also received a copy. (App. Supp. Rule 4, Doc. Tab B) This initiated a lengthy colloquy between the appellant and the CAS Board staff.

On 28 June 1972 the CAS Board sent the appellant an advance copy of the exposure draft to be published in the Federal Register on 30 June 1972, again requesting comments. (App. Supp. Rule 4, Doc. Tab F) The appellant's comments focused primarily upon the three factor base proposed for the allocation of "residual" costs. (App. Supp. Rule 4, Doc. Tab G)

The CODSIA comment to the exposure draft questioned the fundamental concept that home office expenses should be allocated only on a causal or beneficial basis. It said:

"As now written, the theoretically desirable causal or beneficial relationship would have to be established and used and the contractor precluded from using other more practical and less complicated means for allocating certain home office expenses.

\* \* \*

"[The] proposed standard stresses direct allocation to segments to the 'maximum extent practicable to minimize the amount of expenses which may be categorized as residual.' For many kinds of expenses the benefits received and causal relationships cannot be readily measured. To make clearer the intent that materiality and practicality are applicable to this standard, we recommend;

(1) In the second sentence of 403.20 and the first sentence of 403.40, change the phrase 'to the maximum extent practicable' to read 'to the extent practical'.

\* \* \*

(3) . . . Practicality (capable of being done economically) versus practicability (capable of being done without considerations of the economics of the situation) is an extremely important consideration in selecting methods for allocating expenses. . . ." (App. Supp. Rule 4 Doc. Tab H)

The exposure draft of June 1972 asked for comments specifically on the subject of the allocation method for state and local income taxes. The draft gave as an example of central accruals or payments "State and local income taxes and franchise taxes based on income" and as allocation base "the income or loss of such segments." (CAS 403.60; App. Exh. 21)

The appellant did not address the subject in its comments. Others did, however, and consequently the CAS Board revised the language when it promulgated the standard in the December 14, 1972 Federal Register:

For state and local income taxes and franchise taxes the illustrated allocation base was changed to read:

"Any base or method which results in an allocation that equals or approximates a segment's proportionate share of the tax imposed by the jurisdiction in which the segment does business, as measured by the same factors used to determine taxable income for that jurisdiction."

The CAS Board explained in the promulgated introductory statement the reason for the change:

"While some commentators agreed with the proposed illustration, most did not. Of those that did not, most advocated an allocation method which would allocate such taxes on the basis of the same factors used to compute a segment's share of total corporate taxable income, that generally being the percentage of payroll, sales, and property

of the segment to the corporate total of each of these factors. Several commentators noted that they use different allocation bases, such as income or sales, but that these result in approximately the same allocation as one based on the same factors used to compute the tax.

"After evaluating the comments, the Board continues to be of the view that the nature of this expense is essentially the same for all companies. Further, allocation of this expense on the same basis used to compute a segment's share of total corporate taxable income is, in the Board's judgment, more in accord with the concept of allocating home office expenses on the basis of the beneficial or causal relationships between such expenses and receiving segments. The Board has therefore revised the illustration for the allocation of State and local taxes to permit 'any base or method which results in an allocation that equals or approximates a segment's proportionate share of the tax imposed by the jurisdiction in which the segment does business, as measured by the same factors used to determine taxable income for that jurisdiction.' As a practical matter, this means that the tax for any State must be allocated only to those segments that contribute to the factors used to measure taxable income for that State. If there are several segments that do business within a State, each segment's share of that State's tax is to be measured by the proportionate contribution made by such segment to the total of the factors for that State."

On 1 June 1973 the appellant wrote to the chairman of the CASB to express "strong disagreement" with the method of allocating state and local income and franchise taxes. (App. Supp. Rule 4, Doc. Tab I)

There was no income tax in the State of Washington at the time. However, appellant was concerned with proposals then current in the legislature to replace certain property taxes, the tax on business inventories, a portion of the State business and occupation tax, and some sales and use tax with a corporate and personal income tax.

From its perspective it would still be paying taxes but the basis for allocation to segments would be altered. The consequence of such a shift was illustrated by the following chart:

<u>Type of Tax</u>	<u>Description of Base</u>	<u>Boeing Aerospace Co.</u>	<u>Boeing Commercial Airplane Co.</u>	<u>Total</u>
<b>Proposed Tax Structure With Costs Treated as if Allocated to Segments on an Assessment Base</b>				
Business & Occupation	Gross Revenue	30%	70%	100%
Sales & Use	Value of Purchase/Use	31	69	100
Real & Personal Property	Assessed Value	22	78	100
Corporate Income	Factored Formula	<u>28</u>	<u>72</u>	<u>100</u>
Total Cost of Taxes		<u>26%</u>	<u>74%</u>	<u>100%</u>

**Present Tax Structure With Costs Treated as Allocated to Segments on Benefits Received Base**

Cost of all Taxes	Segment Headcount	<u>40%</u>	<u>60%</u>	<u>100%</u>
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The appellant in essence raised the same arguments that it now makes.

On 2 July 1973 the CASB replied. It rejected the appellant's argument as follows:

"... the Board considers that both the benefit from, and the cause of, state and local income taxes is attributable to segments that do business within the taxing jurisdiction. It follows that where there is more than one segment in a jurisdiction, the share of the tax allocable to each such segment should be measured by the same factors used to determine the total tax for that jurisdiction. Thus, for example, if assessable income for any state is determined by a three-factor formula, as it is in a majority of states, the tax allocable to any segment within the state would be the state tax rate times that segment's income as determined by the same three-factor formula. An allocation base or method

which produces a different result, in our opinion, could not satisfy the beneficial or causal relationship criteria of paragraph 403.40 of the Standard and would therefore violate the requirements of the Standard."

On 17 August 1973 the appellant wrote the CAS Board again. (App. Supp. Rule 4, Doc. Tab K) Apparently the CAS Board had apprised the appellant that the Board would reconsider that portion of Part 403 dealing with central payments or accruals, more specifically, the prescribed treatment for state and local income and franchise taxes.

During September and October 1973 the appellant made a substantial presentation of its views to the CAS Board (App. Supp. Rule 4 Doc. Tabs L and M). The scope of its concern seems to have broadened from the income tax allocation question to the question of the appropriate method of allocating all state and local taxes. The appellant explained its sense of urgency derived in part from its awareness of the DCAA interpretation of 403 as requiring an allocation of state and local taxes (other than income taxes) by an assessment base method rather than head count method.

The appellant was not satisfied with the results and on 26 October 1973 wrote the CASB chairman the following (App. Supp. Rule 4 Doc. Tab N):

"The Company was keenly disappointed to learn from the Staff that they not only concurred with the DCAA interpretation that CAS Part 403 required a change in Boeing's long-standing practices but that, according to the staff, it was the *clear intent of the Board* that the guidelines set down in Part 403 made mandatory the use of the assessment base method and would prohibit the use of other cost accounting methods even though such methods clearly would allocate the costs to segments more nearly in accordance with the benefits received in such segments from the governmental services provided by the state and local governmental agencies involved."

On 29 November 1973 the appellant met with the CAS Board and presented an "Application for Ruling." On 20



January 1974 the CAS Board declined the request. (Rule 4, Tab IVA)

### **The Expert Witnesses**

Beside the testimony of the Government auditors and the appellant's controller, the parties presented independent expert witnesses.

The appellant presented Mr. Gerald Gorans. He is a member of the Board of Directors of Touche Ross & Company, the firm of certified public accountants which certifies that the financial statements of The Boeing Company and its subsidiaries have been examined in accordance with generally-accepted auditing standards and that they present fairly the financial position of the company in conformity with generally-accepted accounting principles applied on a consistent basis. (App. Exhs. 4, 24)

The appellant also presented Professor Howard W. Wright. He is a professor of accounting at the University of Maryland. He has been a consultant to the Department of Defense and participated significantly in the preparation of the first complete draft of what became Part 2, Section XV of the Armed Services Procurement Regulation. He authored "Accounting for Defense Contracts," Prentice-Hall, 1962 and other accounting articles for professional journals. (App. Exh. 20)

The Government presented Professor Gordon Schillinglaw. He is a professor of accounting at the Graduate School of Business, Columbia University in New York City. He is the author of "Cost Accounting: Analysis and Control," Richard D. Irwin, Inc., first edition 1961, third edition 1972, and other accounting articles for professional journals. (Govt. Exh. 11)

Mr. Gorans considered that the use of segment head count as a base for distributing the cost of appellant's Washington State and local taxes in the Seattle area to the corporate segments complies with the requirements of CAS 403 (Tr. 731).

He was also of the opinion that although the taxes involved can be identified on an assessment base (Tr. 743), CAS 403 does not "mandatorily require" the appellant to allocate the

taxes on an assessment base. (Tr. 731) However, in his opinion, if the appellant did allocate the taxes on the assessment base, that would not prevent his CPA firm giving an unqualified opinion on the appellant's financial statements because the difference in results that would flow from use of the different bases when considered in relation to the appellant's total financial picture would not be material. (Tr. 739)

Mr. Gorans was unable to cite similar treatment of such taxes by other companies in a situation similar to that of the appellant. His experience is restricted to the Seattle area and in that area he considers the appellant unique as far as having multiple divisions (segments) within the state. (Tr. 740) He pointed out that the problem occurs only with respect to companies to which the ASPR or CAS is applicable since for them the "full absorption" method of accounting is necessary. Otherwise, in the normal situation there is not "total allocability of all costs." The costs in dispute here in the typical corporation are not allocated to segments or at all.

Mr. Gorans' explanation of the basis for his conclusion that the appellant's head count method comports with the requirements of CAS 403 does not involve a step-by-step trip through the language of the standard and his understanding of it which leads him to the conclusion. However, he highlights certain aspects which are important to his conclusion. The concept of causality and benefit used in the standard he considers to be the area of difficulty.

He considers the cause of the tax to be the fact that there is a community that has to have support through the process of taxation in order to provide services to its residents, individual and business. From his experience on the Washington State Governor's committee for a new tax policy in 1971 and 1972 and as a past chairman of the Seattle Chamber of Commerce committee on taxation, he opines that the particular form a tax takes is arrived at by a process of negotiation between various legislative bodies and legislators themselves and that the "assessment base just happens to be one of those things that comes out of all this negotiation process and has little or nothing to do with the form or the amount of tax that happens to be collected." (Tr. 729-30,

733-34) Thus, in his view it may not be said that the assessment base, e.g. an item of personal property such as a table, is the cause of the tax. Neither is it the assessment base that benefits from the tax, in his opinion. "[T]he beneficiary is the Boeing Company and its employees who are availing themselves of the services that are provided . . ." from the taxes. It is this benefit aspect that must carry the principal burden of how those taxes are distributed amongst the various segments. (Tr. 734)

Mr. Gorans contrasts the head count method of allocating the taxes on the basis of benefit with two other "acceptable methods of allocating this type of cost"; one being salary cost and the other, direct labor hours. However, since it may not be said that one with a salary of \$30,000 receives more services than one who earns \$10,000, it may not be said a salary cost basis is good. Likewise, since one who works 48 hours a week does not receive more services than one who works 40 hours a week, the direct labor hour method is not good. Consequently, he concludes, of the various methods available, head count is as satisfactory as one can devise. (Tr. 734-35)

The Government's expert witness, Professor Schillinglaw, had a markedly different opinion both as to whether the appellant's allocation method complied with the requirements of CAS 403 and as to the concepts of benefit and causality.

In Professor Schillinglaw's opinion the respondent's assessment base method of allocating these costs to segments does, and the appellant's head count method does not, comply with the requirements of CAS 403. (TR. 241-2)

He does not consider as relevant to his opinion the fact that the Boeing Company or its segments or their employees receive a benefit from the services performed by the Governmental agencies which services are funded in part by taxes paid by the company. (TR. 248, 285)

In his opinion, the relevant cause of the tax cost is not the community's need for services and funds therefor. Rather, the reason for paying a tax, on property, for instance, is the

fact that the law requires the payment of a tax on property and the fact that the taxpayer owns such property. The way to avoid the tax is to sell the property. (Tr. 240, 250, 252)

Professor Schillinglaw's opinion that the appellant's allocation method does not, and that the Government's allocation method does, comply with CAS 403 is based on his reading of the standard as an accountant. He believes that CAS 403 was intended to provide the first set of criteria for the allocation of costs not traceable to or specifically identifiable with individual contracts which are for that reason by definition indirect costs. Of the wide variety of such indirect costs the CAS Board started with what might be called the first phase of the allocation of such costs by selecting for treatment the allocation of home office expenses to corporate segments, leaving the question of the reallocation of such costs by segments to later standards. (Tr. 226)

He explains that the standard, itself and as explained by the CAS Board in the Federal Register promulgating the standard (Govt. Exh. 14), presents a three tier hierarchy described in a number of places. For instance:

"Research establishes that some home office expenses are incurred for specific segments and can be assigned directly to them. Other expenses, not incurred for a specific segment, have clear relationships to two or more segments, relationships which are measurable with reasonable objectivity. A third type of home office expense possesses no readily measurable relationship to segments.

\* \* \*

"The Standard published today requires that those home office expenses incurred for specific segments are to be allocated directly to those segments to the maximum extent practical. Those that can be allocated to segments on the basis of objective measurable relationships are to be accumulated and allocated by means of logical and homogeneous expense pools established for this purpose. The remaining or residual home office expenses are then to be allocated as discussed below."

He finds the same message in slightly different words in CAS 403.20:

*"§ 403.20 Purpose.*

(a) The purpose of this Cost Accounting Standard is to establish criteria for allocation of the expenses of a home office to the segments of the organization based on the beneficial or causal relationship between such expenses and the receiving segments. It provides for (1) identification of expenses for direct allocation to segments to the maximum extent practical; (2) accumulation of significant nondirectly allocated expenses into logical and relatively homogeneous pools to be allocated on bases reflecting the relationship of the expenses to the segments concerned; and (3) allocation of any remaining or residual home office expenses to all segments. Appropriate implementation of this Standard will limit the amount of home office expenses classified as residual to the expenses of managing the organization as a whole."

He finds this same message in CAS 403.40(a)(1):

*"§403.40 Fundamental requirement.*

(a)(1) Home office expenses shall be allocated on the basis of the beneficial or causal relationship between supporting and receiving activities. Such expenses shall be allocated directly to segments to the maximum extent practical. Expenses not directly allocated, if significant in amount and in relation to total home office expenses, shall be grouped in logical and homogeneous expense pools and allocated pursuant to paragraph (b) of this section. Such allocations shall minimize to the extent practical the amount of expenses which may be categorized as residual (those of managing the organization as a whole). These residual expenses shall be allocated pursuant to paragraph (c) of this section."

Again in CAS 403.40(b)(4) the first two tiers of the hierarchy are restated:

*"(4) Central payments or accruals.* Central payments or accruals which are made by a home office on behalf of its segments shall be allocated directly to segments to the extent that all such



payments or accruals of a given type or class can be identified specifically with individual segments. Central payments or accruals are those which but for the existence of a number of segments would be accrued or paid by the individual segments. Common examples include centrally paid or accrued pension costs, group insurance costs, State and local income taxes and franchise taxes, and payrolls paid by a home office on behalf of its segments. Any such types of payments or accruals which cannot be identified specifically with individual segments shall be allocated to benefited segments using an allocation base representative of the factors on which the total payment is based."

He understands these provisions to establish three sets of criteria. The first is specific identifiability of the cost. If that criterion is met the standard requires the direct assignment of the cost to the segment. If that criterion is not met then a second criterion or set of criteria is applied. The second set of criteria he would call the identifiability of the services provided or used with the segment (CAS 403.40(b)(1), centralized service functions, requires such services provided by the home office to be allocated to segments on the basis of services furnished to or used by each segment) or identifiability of the factors on which payment was made or the cost was incurred. Then, only if neither of the first two sets of criteria can be met, are the so-called residual expenses to be allocated according to a formula set forth in the standard. (Tr. 226-230)

In his opinion the taxes paid (except the Renton license tax) can be identified specifically to each segment, so that the direct allocation of the taxes thus specifically identified to each segment is required under the first sentence of 403.40(b)(4), a first tier in the hierarchy. The Renton tax because it cannot be identified specifically is subject to a second tier allocation. (Tr. 241-242) His conclusion is based upon the undisputed fact that each segment does actually identify by their respective assessment base the taxes incurred by it prior to pooling such taxes in the headquarters pool. The Renton tax because of its graduated nature is not specifically identifiable by its assessment base.

Professor Schillinglaw recognizes some difficulty with the benefit concept. The word "benefit" lacks real content until one tries to get behind it to see what the measure of benefit is. (Tr. 253) To him, trying to measure the benefit one receives from the payment of taxes to determine whether it is "equal to or greater than or less than" is a "matter of metaphysics." (Tr. 250) He notes, of course, that CAS 403.40(a)(1) uses the terms "beneficial" and "causal" (Tr. 253) and that CAS 403.40(b)(4) uses the term "identified specifically" without defining what is meant by the term. (Tr. 249) To him "specific identification . . . means the ability to trace the cost to the segment in which those costs arose or for which they were incurred. . . ." (Tr. 249) It "requires that a cost in its entirety be traceable to a specific cost objective, segment. . . ." A "method which requires a pooling and then a reassignment is not specific identification." (Tr. 251) Thus, he conceives that the words "beneficial" or "causal" are not used so much to define the meaning of "identified specifically" as the words identified specifically are used to explain what the CAS Board meant by "beneficial" or "causal." (Tr. 233, 253)

Professor Wright opined that the appellant's method of allocating the taxes here in issue is in accord with CAS 403. (Tr. 531) His rationale for that conclusion is explained in quite extensive testimony, and utilizes in part factual conclusions premised upon the testimony and documents in this appeal, certain legal conclusions and interpretations of decisions of the Court of Claims and of this Board. These premises must be set forth in order to understand the conclusion.

Professor Wright notes that the basic criterion for the allocation is the beneficial or causal relationship set forth in Sec. 403.40(a)(1). To Professor Wright the phrase "the beneficial or causal relationship between supporting and receiving activities" in CAS 403.40(a)(1) refers to the Boeing Company and its employees as the "receiving activities" which receive the "benefits" of services provided by the various communities which are the "supporting activities." (Tr. 563, 564) The cause of the tax he conceives is the community need for funds in order to provide the community services. (Tr. 563, 566) Further, because the taxes paid should

not be identified specifically with individual segments, they must be "allocated to benefited segments using an allocation base representative of the factors on which the total payment is based." (CAS 403.40(b)(4) This is what he conceives the appellant does. (Tr. 606-607) It is an allocation pursuant to the second tier of the hierarchy of allocation methods.

Professor Wright understands the word "factors" in the sentence above as referring to the "benefits" received by the "receiving activity" and the "base representative" of those factors should be one which permits a distribution of the tax cost to the segments on the basis of those "benefits" received. (Tr. 611-613)

In choosing the base, he is influenced by CAS 403.50 "Techniques for Application" especially subparagraph (b)(2). Sections (b)(1) and (2) state:

"(b)(1) Section 403.60 illustrates various expense pools which may be used together with appropriate allocation bases. The allocation of centralized service functions shall be governed by a hierarchy of preferable allocation techniques which represent beneficial or casual [sic] relationships. The preferred representation of such relationships is a measure of the activity of the organization performing the function. Supporting functions are usually labor-oriented, machine-oriented, or space-oriented. Measures of the activities of such functions ordinarily can be expressed in terms of labor hours, machine hours, or square footage. Accordingly, costs of these functions shall be allocated by use of a rate, such as a rate per labor hour, rate per machine hour or cost per square foot, unless such measures are unavailable or impractical to ascertain. In these latter cases the basis for allocation shall be a measurement of the output of the supporting function. Output is measured in terms of units of end product produced by the supporting function, as for example, number of printed pages for a print shop, number of purchase orders processed by a purchasing department, number of hires by an employment office.

"(2) Where neither activity nor output of the supporting function can be practically measured,

a surrogate for the beneficial, or causal relationship must be selected. Surrogates used to represent the relationship are generally measures of the activity of the segments receiving the service; for example, for personnel services reasonable surrogates would be number of personnel, labor hours, or labor dollars of the segments receiving the service. Any surrogate used should be a reasonable measure of the services received and, logically, should vary in proportion to the services received."

He concludes that subparagraph (b)(2) has significance for the allocation of taxes "because neither the activity nor the output of the supporting function can be practically measured in any beneficial relationship." (Tr. 616, 619) Consequently, it is necessary to select a "surrogate" to represent the relationship. Since in his view the segments' workers receive the services as workers and as members of the community, it is reasonable to use the number of personnel, or labor hours or labor dollars, all essentially head count type bases, as a surrogate. This fulfills the guidance in the last sentence of (b)(2) that the surrogate logically should vary in proportion to the services received in that "as the employment in each division ebbs and flows, the tax allocation ebbs and flows in precisely the same proportion or ratio." (Tr. 620) Also, "increases and decreases in employment in the several Boeing divisions, do vary in proportion to the services received by Boeing and by its employees as residents and members of the community..." (Tr. 720)

Professor Wright takes issue with the Government's position on a number of bases. In his judgment since the terms beneficial and causal are used in the disjunctive in CAS 403.40(a)(1), a contractor need satisfy only one of these criteria, and it would not be up to the Government to decide which one. While acknowledging he is not a lawyer, he testified he knows "one of the basic principles of law is that where ambiguities exist, the contract shall be interpreted adverse to the party who prepared it and if that is true, in this case the government doesn't have the right to select, given two equal alternatives, which alternative it cares to rely on." (Tr. 549)

He acknowledges that taxes can be identified specifically with the individual segments (Tr. 580) as the respondent contends, on an assessment base approach. But, he does not believe that is proper because the second sentence of CAS 403.40(a)(1) which calls for expenses to be allocated directly to segments requires this to be done only "to the maximum extent practical." (403.40(a)(1)) He believes that the Government interpretation ignores that clause. (Tr. 573) He concludes that in the absence of any definition of the word "practical" in the CAS he is obligated to look to a reputable dictionary. The 1966 version of The Random House dictionary of the English language, at page 1128, gives as one definition "7 . . . Mindful of the results, usefulness, advantages or disadvantages, et cetera, of action or procedure." It is synonymous with judicious and sensible. (Tr. 574-575) In his judgment:

"... the use of an assessment base for the allocation of the state and local taxes here at issue does not result in any sort of sensible allocation. It tends to be arbitrary, mechanical in the sense that the assessment base generates the tax and therefore if we followed it back we dispose of all of our problems. But as a, 'practical,' matter, such a base ignores the benefit concept and it is for that reason that it is my opinion that the inclusion of that phrase in that second sentence to the maximum extent, practical, under the facts of this case means that Boeing does not have to allocate in accordance with the assessment base as the government asserts because to do so would create an allocation that is substantially not in accord with any beneficial concept." (Tr. 577-578)

His opinion in this respect is reinforced by the fact that the exposure draft of CAS 403 published in the 30 June 1972 Federal Register, Volume 30, No. 127, used the word "practicable" rather than "practical." "Practicable" according to Professor Wright means "capable of being done, effected or put into practice with the available means, feasible; a practicable solution." (Tr. 579) He concludes that the change in wording is significant.



"The important thing to me here is the government is interpreting that second sentence of [CAS 403.40(a)(1)] as though the word practicable were still there, because The Boeing Company admits, as the government asserts, that it is possible to identify these taxes with the division in which the property is located or which engaged in the transaction upon which the tax is based.

"It is my opinion, however, that the change in that word, from practicable to practical, makes possible the interpretation that the results of any such direct allocation must result from the exercise of sound judgment, or in the alternative must . . . not be foolish." (Tr. 580)

Professor Wright was aware that the CASB explanatory remarks preceding the CAS 403 published in the 14 December 1972 Federal Register, Vol. 37, No. 241 at page 26681 (Govt. Exh. 14) explained the comments that it had received on the June exposure draft which had used the word "practicable." It said:

"(1) *Materiality*. Many commentators urged that the Standard contain a general statement on materiality. The Board has previously stated that the administration of its rules, regulations, and Cost Accounting Standards should be reasonable and not seek to deal with insignificant amounts of cost. The Board does not believe that any further general statement is needed at this time. However, where specific changes could be made to clarify the intent of this Standard with respect to materiality, they have been made as further discussed below.

"While most commentators agreed with the concept of maximum direct allocation of home office expenses, and accumulation of nondirectly allocated home office expenses into logical, homogeneous expense pools, a few of these commentators believed that the Standard did not adequately incorporate the concept of materiality for this purpose. The Board agrees that materiality is an important consideration in determining whether to specify that an expense is to be allocated directly or by means of a separate expense pool. Accordingly, § 403.40 of the Standard has been revised to state that expenses are to be allocated

to the maximum extent 'practical' and that expenses not directly allocated are to be grouped into separate homogeneous expense pools 'if significant in amount and in relation to total home office expenses.'"

Professor Wright recognized that a reason for the change was the impact of materiality but he believes if the Board wanted to achieve only the result indicated by the above-quoted paragraph it should have put a limitation on it by adding "provided substantially the same results are achieved" by less precise methods. (Tr. 575, 581) Not having done that he believes it is open to the interpretation he suggests even if not intended. (Tr. 581)

Professor Wright's opinion is strongly influenced by the decision of this Board in the appeal of the *Boeing Company*, ASBCA No. 11866, in September 1969. (Tr. 598) That appeal concerned whether taxes paid on property used solely under non-Government contracts could be allocated to Government contracts at all and, if so, whether the taxes could be pooled and allocated to Seattle divisions on a head count basis. The case was decided under the ASPR cost principles in effect at the time.

Although Professor Wright did not testify for either side in that appeal, his book, *Accounting for Defense Contracts*, Prentice Hall, Inc. 1962, was cited by the Government in support of its position therein. He notes the particular language from his book quoted by the Board, as follows:

"Commenting upon the question of the allocation of taxes on the basis of assessments, the authority quoted above does present a respectable basis in support of such a viewpoint:

"Indirect costs don't 'just happen.' They are caused by managerial decision, governmental action, or other circumstances. Most indirect expenses are incurred to accomplish something; there is a benefit to several cost objectives. \* \* \* The primary principle in allocating indirect expenses is that such expenses should be allocated to the benefited cost objectives in proportion to the benefit accruing to the several benefited cost objectives.

"The benefit of other indirect expenses is not as measurable or immediate as that discussed in the previous paragraph. In some instances, e.g., property taxes, it is impossible to measure a benefit; it can only be assumed. In these cases there is a cause and effect relationship. The cause is the ownership of the property; the effect is the tax on such property. The first is not possible without the second. In cases in which a cause and effect relationship exists, the expense should be allocated to the several cost objectives in the same proportion that the cost objectives benefited from the use of the causative factor. [Footnote omitted] Thus property taxes on a manufacturing plant should be allocated to departments and products as is the depreciation on the plant."

Then, he points out that this Board "considered what I had written with respect to the allocation of taxes on a causal basis and determined that those views should be rejected. . . ." (Tr. 598) He considers that he learned something from the Boeing case which under the facts of that case expresses good accounting, particularly when one considers the analysis of the benefit concept on which it was based. (Tr. 599)

The professor is not to be understood as recanting the language quoted from his book. He considers that a cause and effect relationship exists between the ownership of property and the tax placed thereon, that expenses should be allocated to the several cost objectives in the same proportion that the cost objective benefits from the use of the property, and he speculates, on the basis of his conversations with CASB staff members, that the causal relationship referred to in 403.40(a)(1) is the foregoing. (Tr. 600-602) However, he explains:

"THE WITNESS: The words that are in that book were not there in recognition of any conglomerate situation in terms of divisions. It was not there in terms of the totally complex situation that exists in the Seattle area with respect to the location of the several plants and the differences in taxation and the aggregation of taxes et cetera." (Tr. 602)

It was not only the Board's treatment of the language from his book that influences his opinion. He points out that the

Board dealt with the words "identified specifically" in such a way as to indicate that they did not control the allocation "primarily because they did not result in a beneficial allocation." (Tr. 604)

These words are found in CAS 403.40(b)(4) requiring central payments to be allocated directly to segments to the extent it "can be identified specifically with individual segments." They are also used in the pertinent ASPR 15-202 "Direct Costs" in the sentence "(a) A direct cost is any cost which can be identified specifically with a particular final cost objective." It was also used in the previous ASPR 15-202 in a similar sentence: "(a) A direct cost is any cost which can be identified specifically with a particular cost objective."

Professor Wright notes the alteration in the concept of "Direct Cost" which previously might have described a cost identified specifically with a particular cost objective. It was altered to describe only those so identified with a *final* cost objective which is by definition a contract. He finds this confusing in that it creates a concept of indirect costs which are *directly allocable* if they can be identified specifically with individual segments. (Tr. 591-595) Nonetheless, he points out that a segment is a particular cost objective under the earlier language in ASPR 15-202 which was considered by the Board in *The Boeing Company*, ASBCA No. 11866; that it was the Government's position therein that since the tax cost could be identified specifically with that cost objective (segment) direct charging of the taxes to that cost objective (segment) should be employed; and that this Board rejected that "direct charging" approach.

## DECISION

### The Contentions of the Parties.

The parties are in agreement that the resolution of the dispute herein is dependent upon a proper interpretation of CAS 403.40(b)(4) with which the appellant's allocation of home office expenses to segments must comply. It reads:

"(4) *Central payments or accruals.* Central payments or accruals which are made by a home

office on behalf of its segments shall be allocated directly to segments to the extent that all such payments or accruals of a given type or class can be identified specifically with individual segments. Central payments or accruals are those which but for the existence of a number of segments would be accrued or paid by the individual segments. Common examples include centrally paid or accrued pension costs, group insurance costs, State and local income taxes and franchise taxes, and payrolls paid by a home office on behalf of its segments. Any such types of payments or accruals which cannot be identified specifically with individual segments shall be allocated to benefited segments using an allocation base representative of the factors on which the total payment is based."

The Government focuses on the first sentence and concludes most of the taxes here in issue must be "allocated directly to segments" because they "can be identified specifically with individual segments."

The appellant considers the operative requirement is the last sentence and concludes these central payments or accruals "cannot be identified specifically with individual segments" so must be "allocated to benefited segments using an allocation base representative of the factors on which the total payment is based." Head count, as a surrogate, is a base representative of such factors, it argues.

As to the Renton license tax which is based on a graduated scale, upon the number of employees working in Renton, the Government contends that since it cannot be specifically identified with an individual segment, it should be allocated to the segments on the basis of the relative head count of the segments' employees working in Renton. This is also an allocation pursuant to the last sentence of CAS 403.40(b)(4). However, it is different from the method used by the appellant. The Government concludes that Renton head count is the basis on which the tax is levied, and so is an "allocation base representative of the factors on which the total payment is based." Only segments with employees in Renton would be allocated the tax and each only to the extent of its share of the Renton employees. The appellant, on the



other hand, uses head count as a surrogate. The head count is that of each Washington segment in relation to total Boeing Washington area head count.

#### **The Boards Conclusion.**

We conclude that CAS 403.40(b)(4) requires each tax to be "allocated directly to segments" on its assessment base if the tax "can be identified specifically with individual segments" on such a base.

Each of the taxes in issue herein has a certain base upon which it is computed. Each tax, except the Renton license tax, can be specifically identified with a particular segment by that base and in fact is so identified by each segment prior to the home office pooling of all such taxes.

The Renton license tax which cannot be specifically identified with a particular segment, should be allocated on the basis of its assessment base, Renton head count, because that base is "representative of the factors on which the total payment is based."

#### **The Interpretative Approach.**

Cost accounting standard 403 provides the first authoritative accounting statement concerned specifically with the allocation of home office expenses to segments. Prior to its promulgation the matter of such allocation was considered within the framework of the ASPR cost principles which did not specifically address the allocation of home office expenses to segments. In that prior context this Board considered the appellant's head count method of allocating these home office expenses to its segments against the Government's contention that they should be treated as direct costs of the segments specifically identified with the segment by the assessment base of each tax. The Board concluded that the appellant's method was permitted by the applicable provisions of ASPR. *The Boeing Company*, ASBCA No. 11866, 69-2 BCA par. 7898; on reconsideration 70-1 BCA par. 8298. The appellant sought review by the Court of Claims of that part of the decision unfavorable to it. The Court affirmed that portion of the Board's decision

favorable to Boeing, concluding that the Board was correct in its exposition of the applicable law and that the record supported the Board's conclusion that Boeing's method of allocation accorded with generally-accepted accounting principles. *The Boeing Company v. United States*, 202 Ct. Cl. 315 (1973).

The appellant naturally leans heavily upon its prior victory. It insists that if the CAS Board intended to reverse these prior cases, of which it was surely aware, it should have said so. (App. Brief, pp. 54-63). The argument has two aspects. In one aspect the appellant argues that there should have been an explicit rejection of these precedents by the CAS Board, especially in view of appellant's lengthy dialogue with the Board and its staff concerning the allocation of taxes. This argument is not especially persuasive. The Government points to that evidence which indicates that the Board *staff* understood the base for allocating taxes to be the assessment base as contended by the Government. (Respondent's Brief, pp. 63, 64) The *staff*, of course, is not the CAS Board says the appellant. (App. Reply Brief, p. 27) From our point of view, while legislative or administrative history of a law or regulation may sometimes disclose an explicit legislative intent to overturn certain precedents, it most often does not. We do not see the CAS Board's failure in so many words to disavow the prior ASBCA and Court of Claims' decisions as a contrary indication that they are still considered viable in the light of the promulgated standard.

The second aspect of the argument is that if the CAS Board intended to reverse these precedents; it should have published a standard sufficiently clear to make it plain what it meant to do. This argument amounts to an assertion by the appellant that its interpretation of the standard is different from the Government's interpretation and that therefore the CAS Board's intent is not plain. To this the appellant adds that, if there is ambiguity in CAS 403, it must be resolved against the Government, since the Government drafted the standard and made it a part of the contracts. (App. Brief, p. 55)

This aspect of the appellant's argument is not persuasive. Although the obligation to comply with the CAS is found in the contract, the correct interpretation of the standard is to give effect to the standard according to the intent of the rule makers. In this context the rule of legislative interpretation and not contract construction, as urged by the appellant, is applicable. See *LTV Aerospace Corporation*, ASBCA No. 17130, 76-1 BCA par. 11840 and cases cited therein.

### **The Critical Issue.**

At the very heart of this dispute is appellant's concept of benefit and cause. It asserts that the cause to be concerned with is the cause of the imposition of a tax. This it concludes is the community's need for services. So far as such need reflects the reason why the taxing authorities levy a tax, we agree it is certainly a cause. It also contends that the benefit to be concerned with is the benefit that the corporation and its segments, receive directly from the community services, and indirectly through benefits to its employees. So far as this is an assertion that there is a benefit to those within Washington from the services provided by the State and other communities there is certainly a benefit.

The testimony of Mr. Pilskey respecting the various uses to which taxes are put in Washington State and the benefit that inures to those persons and corporations residing there has been set forth in some detail due to its obvious importance to the appellant's approach to this dispute. We accept it to the extent it shows a benefit. However, the Government does not really challenge the conclusion that there are benefits to corporations operating in Washington State from the taxes paid to the State. We accept also the Pilskey conclusions that such benefits are not susceptible to objective measurement.

We say the concept of benefit and cause is the heart of the dispute because the appellant agrees that CAS 403 establishes a preferential hierarchy of allocation methods described in CAS 403.20(a). (App. Reply Brief, p. 1) Further, it agrees, or at least "does not disagree" that most of its Seattle area taxes could be identified with its Washington

segments by the assessment base. Likewise, it "does not disagree" that "a form of" causal relationship could exist between the assessment base used for measurement of a tax and the tax itself. This approach it disparages as being merely "mechanical, mathematical" although it might be appropriate "if such an allocation is reasonably in accordance with benefits" as it construes benefits. (App. Reply Brief, p. 37)

The critical question we must resolve then, is how the CAS Board used the concepts of "benefit" and "cause," with particular reference to taxes. The standard provides some help in this respect.

CAS 403.60 provides some illustration of various home office expenses typically pooled and allocation bases which could be used in appropriate circumstances. Although the precise types of taxes in issue here are not alluded to, state and local income taxes and franchise taxes are mentioned as central payments or accruals. The illustrative allocation base is:

"Any base or method which results in an allocation that equals or approximates a segment's proportionate share of the tax imposed by the jurisdiction in which the segment does business, as measured by the same factors used to determine taxable income for that jurisdiction."

We believe that the CAS Board has hereby adopted an assessment base method of allocating these taxes, and, furthermore, by so doing has demonstrated that such a base comports with its concept of the beneficial or causal relationship alluded to in Sec. 403.40 as Fundamental Requirements. This conclusion is supported by the fact that in Section 403.60(c) where the CAS Board purports to permit other bases for allocation of home office expenses to segments, it restricts them to only such as are "substantially in accordance with the beneficial or causal relationships outlined in Sec. 403.40."

In its prior exposure draft of the standard the CAS Board had given as an illustration of a base for allocating state and local income taxes to segments "the income or loss of such segments." It evidently considered this also effected an

allocation according to the beneficial or causal relationships set forth in Sec. 403.40 since it used the same language to indicate that other bases might be used if substantially in accord with such relationship.

The appellant argues that the CAS Board's revision of this aspect of the standard is supportive of its position. It says:

"The CAS Board Rejected the Assessment Base as a Surrogate For Allocation of All State and Local Taxes By Rejecting the Assessment Base as a Surrogate for State Income and Franchise Taxes." (App. Brief, p. 47)

The appellant considers "income or loss" as an assessment base method of allocating State income taxes. We would agree. The appellant, however, seems to speak of this assessment base as a "Surrogate." This characterization is consistent with its conception of benefit as the services received from the community; however, it is of no help in determining whether the CAS Board had that conception. It is difficult to imagine that the CAS Board, even initially, conceived of a segment's "loss" as in any respect a surrogate for benefits received from community services. Without belaboring this point it may be noted that this Board has considered "income and loss" as a basis for allocating income tax, and at least under the facts of the particular case upheld such an allocation. See *Univac Division, Sperry Rand Corporation*, ASBCA No. 13588,70-2 BCA par. 8555. Professor Wright and a collaborator, James P. Bedingfield, had the following to say about this case and *General Dynamics Corporation*, ASBCA No. 13868, 69-2 BCA par. 8044 which dealt with a franchise tax:

"The main point involved in summarizing these two cases is to emphasize the inadequacy of a pure benefit concept as a criterion for allocating taxes based on income. Neither decision included any substantial discussion of benefit. Rather, each decision sought the cause of the tax and was based on the Board's conclusion as to the cause. In the last analysis, the decisions were based on equity. Benefit provided no basis for the decisions because it could not be measured." "Benefit as a Criterion for Indirect



Cost Allocation, The Federal Accountant," Vol. XXII, Number 3, September, 1973.

The CAS Board changed its illustration, a segments income or loss, as a base for allocation and adopted as a test of any allocation base its conformance to results "measured by the same factors used to determine taxable income for that jurisdiction." We note that various states imposing income taxes on corporations doing business within the state rather than utilize the income or loss that may be reflected on the corporations books as income or loss of the particular segment in that state prefer to measure the income subject to taxation by the state by utilizing a more objectively measurable base. Thus those states measure the property, payroll, and sales within the state as a percentage of the corporations total property, payroll and sales. That percentage applied to the corporations total income determines for that state the taxable income.

The appellant contends that such is not an assessment base method but is "a surrogate for determining how much of the corporate income is properly allocable to the state." The appellant then concludes:

"It is significant indeed, that with respect to the only state taxes dealt with by the CAS Board in CAS 403, the Board, after first tentatively adopting an assessment base allocation method, subsequently, in the final version of CAS 403 as adopted, moved away from the assessment base, and made a determination that a surrogate, i.e., the property, payroll and sales three-factor formula, was 'more in accord with the concept of allocating home office expenses on the basis of beneficial or causal relationship' than was the assessment base." (App. Brief, p. 48)

The thrust of the appellant's argument is that the factors are a surrogate for measuring the benefits received from community services just as its head count is a surrogate for measuring such benefit.

We disagree that the CAS Board moved away from the assessment base method. We consider those factors used to measure a corporation's taxable income are the factors which

in fact comprise the assessment base of the tax. Thus, we believe the CAS Board in changing the base from "income or loss" to any base which produces results such as would be obtained using as a base "the same factors used to determine taxable income" in a particular state merely moved from the nominal assessment base to the base on which the state's tax is actually assessed.

The significance of the CAS Board's adoption of this actual assessment base for judging the acceptability of an allocation method for income taxes is that it reflects its understanding that such a method is in accord with its concepts of beneficial or causal relationships. Indeed, the Board explained in the statement promulgated with CAS 403 that in its judgment:

"... allocation of this expense on the same basis used to compute a segment's share of total corporate income is ... more in accord with the concept of allocating home office expenses on the basis of the beneficial or causal relationships between such expenses and receiving segments."

The CAS Board's treatment of the allocation base for income taxes specifically in Section 403.60 is helpful in understanding the language it used in Section 403.40(b)(4) concerning central payments and accruals generally. There, after noting that state and local income taxes is a common example of such payments, it said:

"Any such types of payments or accruals which cannot be identified specifically with individual segments shall be allocated to the benefited segments using an allocation base *representative of the factors on which the total payment is based.* (Emphasis added)

We appreciate that the underscored language is somewhat more general than the language utilized in CAS 403.60, but we have no doubt that as it pertains to income taxes it is intended to and does mean the same thing, i.e. the total payment is the State income tax payment and the factors are those which are used to measure the State income. The generality of the language is merely so it may be read more readily with respect to other types of central payments or accruals. It is also evident from the above-quoted sentence

that the CAS Board considered that an allocation of income tax expense to segments on the basis of the factors used to measure State income, i.e. on an assessment base, would effect an allocation to "benefited segments".

An explanation of what the CAS Board meant by "benefited segments" is found in its explanatory statement promulgated with CAS 403. There it explains that:

"... the tax for any State must be allocated only to those segments that contribute to the factors used to measure taxable income for that State. If there are several segments that do business within a State, each segment's share of that State's tax is to be measured by the proportionate contribution made by such segment to the total of the factors for that State."

It is quite clear therefore that "benefited segments" are deemed those that contribute to the factors used to measure taxable income, and that the segment's share of that State's tax is to be measured by its proportionate contribution to the assessment base. The same logic is applicable to other state and local taxes.

The appellant takes a different view of the last sentence of CAS 403.40(b)(4). It argues that the "total payment" is the total of all of Boeing's Washington state and local taxes; this because "only by aggregating all of the taxes into a single pool do we get the logical, homogeneous expense pool referred to in 403.20 and 403.40(a)(1), because none of the taxes benefits solely any one segment. On the contrary it argues that each of the several types of taxes Boeing pays finances governmental services which benefit all of Boeing's business conducted in Washington; i.e., all of its Washington segments." (App. Brief, p. 42)

Appellant argues that the "factors" on which the "total payment" thus conceived is based are Boeing's property, sales, purchases, "in effect its total business activity in Washington." But rather than allocate the various taxes to a segment according to its proportionate contribution of those factors used by the State in computing the tax, it

resorts to head count as a surrogate for its total business activity because it considers itself labor intensive.

Its approach, as we said, is grounded upon the premise that benefit is the receipt of services from the community. Since all taxes go to pay for such benefits it in the first instance accumulates all the various taxes in one pool and then distributes them on the basis of a surrogate.

While its method of accumulation is consistent with and, indeed dependent upon its theory of allocation, it is not, in our judgment consistent with the major emphasis of CAS 403. The hierarchy of preferential methods of allocation emphasizes the objectivity of the measurement mechanism. For instance even when speaking of second tier allocations, those from pools, the CAS Board's explanatory statement points to the importance of "clear relationships to two or more segments, relationships which are measurable with reasonable objectivity." The thrust of the standard is that resort is to be had to surrogates when a "home office expense possesses no readily measurable relationship to segments." Now, such objectively measurable relationships do exist between the various taxes and the various segments. Indeed, the objective measurability of these taxes with segments is of such a high order that for the most part they permit such an identification with each individual segment as would permit a direct allocation.

The relationship between the criteria for accumulating expenses into a pool and for their distribution from that pool is well explained by Professor Wright in *Accounting for Defense Contracts*, Prentice Hall, Inc. 1962 at p. 60.

#### *"Distribution Bases*

Criteria for the selection of a base over which to distribute indirect expenses are the same as those governing the number and composition of overhead pools. The base is an equally important part of the mechanism for indirect expense allocation, and must be selected so as to cause a distribution to the cost objectives in accord with benefit received, reason for incurring the cost, or logic and reason. The selected base must be common to all cost

objectives to which the item or pool is to be distributed. To be acceptable, the portion of the base in each cost objective must vary directly with the amount of indirect expense desired to be allocated to each. This is only logical because it is the variations in the portions of the base in each cost objective which cause different amounts of indirect expenses to be allocated to each."

This relationship is acknowledged by the appellant in arguing for its method of pooling on the theory that "none of the taxes benefit solely any one segment." (App. Brief, p. 42) However, the selection of a distribution theory that requires resort to a distribution on the basis of a surrogate, and then accumulating all taxes in one pool, when in fact other more objectively measurable distribution bases exist which permit of a second tier allocation and even a first tier direct allocation, albeit they imply a pool of each tax with the same base, or even the omission of a pooling step, is contrary to the preferential hierarchy established by CAS 403.

The appellant's emphasis on its theory of the benefits received by segments does not alter this. The CAS Board conceives that an allocation of income taxes to segments measured by the segment's contribution to the assessment base of that tax is in accord with the beneficial and causal relationships between the tax expense and the segment. We are convinced that to be consistent with that intent the taxes here in issue should be thus allocated. Likewise, consistent with this intent, so far as the tax according to these same measuring methods may be identified with a particular segment without the need for pooling, the tax expense is to be directly allocated to the segment.

#### **Other Issues - The Meaning of "Practical".**

Appellant's other arguments suffer the same defect in premise and strain the meaning of the standard's language.

The appellant points to the CAS 403.40(a)(1) statement of fundamental requirements language that home office expenses "shall be allocated directly to segments *to the maximum extent practical*." (Emphasis by the appellant) It then argues that an allocation according to the tax



assessment base does not result in an allocation according to the benefits received by the segments from the Governmental services which are funded by the taxes, consequently, such an allocation is not practical. This argument is based on Professor Wright's testimony set out earlier.

We are unpersuaded that the CAS Board ascribes the same intention as appellant to the words "to the maximum extent practical." The CAS Board's explanation of the reason for changing the word "practicable" to "practical," read in conjunction with the CODSIA comment set out earlier which pointed to the distinction between practicality (capable of being done economically) and practicability (capable of being done without considerations of the economics of the situation), convinces us that the words only limit the need for direct allocation when the amount of the cost is insignificant in relation to the problems that can inhere in tracing the cost to the segment. It does not function in such a limiting sense here because that tracing ability exists and the costs are not insignificant.

**The Meaning of "on behalf of", "incurred for," "intended to benefit".**

The appellant points to the CAS Board Statement of Operating Policies, Procedures and Objectives dated March 1973 as follows:

*"As an ideal, each item of cost should be assigned to the cost objective which was intended to benefit from the resource represented by the cost or, alternatively, which caused incurrence of the cost."* (Emphasis appellant's)

and to the following language from the explanatory remarks promulgated with CAS 403:

*"The Standard published today requires that those home office expenses incurred for specific segments are to be allocated directly to those segments to the maximum extent practical."* (Emphasis appellant's)

and also the language in CAS 403.40(b)(4):

"Central payments or accruals which are made by a home office *on behalf of* its segments shall be allocated directly to segments. . . ." (Emphasis appellant's)

From this it argues:

"Here, Boeing's tax costs are not 'incurred for' or 'on behalf of' any segment. They are costs of The Boeing Company. They are not incurred for or intended to benefit a specific cost objective or segment; they are incurred for and they benefit Boeing's business as a whole. Direct allocation of such costs on the assessment base method is wholly incompatible with CAS 403. Under that Standard, direct assignment is to be used when the relationship between the cost and the cost objective is such that a single objective is intended to be benefitted. Any specific identification to be made for purposes of direct assignment or allocation of costs must be reasonable and consistent with the fundamental requirement of CAS 403 as a whole." (App. Brief p. 35)

The argument is not persuasive. It fails to follow its own direction, that is, to consider CAS 403 "as a whole." CAS 403 deals in general terms with many home office expenses. Many of them are more aptly spoken of as being "incurred for" or "on behalf of" or as being "intended to benefit" a segment. However, so far as the appellant acknowledges that these taxes are to be treated as central payments or accruals, it acknowledges that they are in the sense of the standard paid "on behalf of" the segments. When speaking of the cost of paying taxes, the words "incurred for" or "on behalf of" or "intention to benefit" are slightly strained when the tax is technically not levied upon a segment itself. However, that same difficulty inheres in the use of those words when speaking of the payment of income taxes. Yet, reading the standard as a whole, the CAS Board plainly treated such payments as central payments and accruals, on behalf of, incurred for and allocated to the benefitted segments in accord with the beneficial or causal relationship between the payment and the segment when they are allocated to the segments on the basis of the segments' contribution to the factors which constitute the assessment base.

**Prior Treatment of the Words "identified specifically".**

The appellant emphasizes that the words "identified specifically with" individual segments as used in CAS 403.40(b)(4) and relied upon by the Government as calling for "direct allocation," are the same words used in the 1959 version of ASPR Sec. 15-202 "Direct Costs" which was relied upon by the Government in its earlier challenge to the appellant's head count method of allocating the taxes here in issue. In that earlier version of ASPR a direct cost was defined as "any cost which can be identified specifically with a particular cost objective." The Government contended that the tax cost could be specifically identified with the segment (a particular cost objective) by the assessment base approach and that that was the only way an equitable allocation could be effected. This argument was rejected by this Board under the guidelines then in effect since those guidelines, especially ASPR 15-201.4 "Definition of Allocability" permitting allocation to "a particular cost objective . . . in accordance with the relative benefits received or other equitable relationship" as interpreted by the Court of Claims in *Lockheed Aircraft Corp. v. United States*, 179 Ct. Cl. 545, permitted looking to the benefits received from community services as the benefit to be measured by the allocation. The Board concluded that the appellant's head count method of allocation was an acceptable measure of such benefit under generally-accepted accounting principles.

Although the CAS Board modified the definition of direct cost to include only those specifically identifiable with a "final" (rather than particular) cost objective, e.g. a contract, and thus placed the Government's argument under the CAS 403 language calling for "direct allocation" of an "indirect cost," the ASPR language in 15-201.4, quoted above, was not changed. Why, then, one must ask, should not that language permit measuring benefits received from community services on a head count basis? Our answer is that CAS 403 concept of allocation according to beneficial or causal relationships, as evidenced by its treatment of the allocation of income taxes, contemplates that a benefitted segment's share of the tax payment will be measured by such

a base as will measure the proportionate contribution to the factors that constitute the assessment base of the tax. Rather than measuring the benefits received from community services by the Corporation, its segments, and its employees, it measures the contribution to those factors that give rise to or cause the assessment of the tax, and the benefit which may be conceived of as accruing to the segment by the home office payment of the tax.

#### **Must "all" Taxes be in One Pool?**

The appellant challenges the Government application of the first sentence of CAS 403.40(b)(4) which calls for direct allocation "to the extent that all such payments or accruals of a given type or class can be identified specifically with individual segments." The appellant contends that since "all" taxes cannot be specifically identified with individual segments (the Renton license tax being the one the Government admits cannot be so identified) the first sentence of CAS 403.40(b)(4) is inapplicable.

The argument is not persuasive. Its fallacy derives from the appellant's conception of all taxes being for the same purpose, i.e. the funding of community services and so all includable in one pool with one (head count) base. We perceive no difficulty in treating each tax with a different assessment base separately and directly allocating those which may be specifically identified thereby with an individual segment and that which is not so identifiable being distributed on a base representative of the factors on which it is based.

#### **Does the Government Interpretation Make a "sham" of CAS 403?**

One further aspect of the appellant's argument bears comment. The appellant argues:

"The Government here confuses uniformity in bookkeeping with uniformity in results: What sense does it make to establish a Cost Accounting Standard mandating use of an assessment base allocation method, when a contractor can use a different method by moving his tax office out of Headquarters and into a division such as SSD?

How does it promote uniformity to require that a contractor allocate all of the tax costs incurred on the sale of an Air Force jet to the division which made the sale — even though most of the work was performed in another division, and even though the benefit from the taxes is shared with such other division? (See Tr. 136-138.) How does it promote uniformity to require that all property taxes on a building be allocated to the segment which is the 'landlord' of the building, even though substantial sections of the building are used exclusively by other segments?

"If the goal of uniformity is more than the simplistic goal of requiring uniform bookkeeping practices, then the circumstances in which costs are incurred must be examined, so that cost allocations can be related in a sensible way to the reasons for the incurrence of the costs. Otherwise Cost Accounting Standards will prove a sham. A contractor would simply organize his operations so that costs are allocated to the segments where they will prove most advantageous. Presumably, Boeing would find it advisable to move its tax staff to SSD; or to revise the assignment of its buildings among its segments; or to change contracting responsibility and work performance responsibility among segments, to assure that the 'right' segment gets the 'right' costs allocated to it, irrespective of who really does the work or who is benefited by the costs at issue. While such elevation of form over substance may satisfy a rigid interpretation of the rules, it can hardly be the kind of uniformity which Congress intended the CAS Board to provide. And it is not the kind of accounting which Boeing considers appropriate:

\* \* \*

"The intention of Congress in establishing the CAS Board must have been to require allocational uniformity in uniform circumstances, so that all costs incurred in like circumstances are allocated alike. Indeed, this must be the fundamental goal of cost accounting itself, to assign costs in a uniform manner with respect to the reasons for, or the circumstances of, their incurrence.

"CAS 403 is only one of a series of Standards. It deals with an intermediate step in the process of



properly allocating headquarters cost to final cost objectives. Allocation from headquarters to segments must be followed by allocation from the segments to the final cost objectives. If the intermediate step is not sensible, logical and in accordance with beneficial or causal relationships, then the subsequent allocation from segments to final cost objectives is much more complicated and difficult, if indeed it can be accomplished at all in a sensible or logical way. Because CAS 403 deals with an intermediate step occurring prior to the ultimate allocation of costs to final cost objectives — which is the goal of the whole process — it must be based on principles which go beyond mere bookkeeping uniformity. If this first step is not uniform in the sense of being consistent with the ultimate goal of assigning like costs in a like manner, then inevitably the next steps will be fatally skewed from that goal."

The appellant suggests that CAS 403 as interpreted by the Government and, as it turns out, as we interpret it, is a sham and an elevation of form over substance. It suggests that the consequences that flow from treating the taxes as home office expenses under our interpretation can be avoided by moving its tax office out of its home office and placing it in a service segment. It suggests that it can alter the identification of the tax cost with a particular segment by revising the assignment of segment responsibility for facilities or work performed so that the "right" segment gets the "right" costs. Thus, if it were so disposed, which of course we do not suggest it is, it could load the tax burden on the Government work.

We must acknowledge the appellant's ability to reorganize itself as suggested. Whether the predicted consequences would follow we need not and do not decide. This does not alter the fact that as presently constituted the appellant does treat these costs as home office expenses to be allocated to segments. As such the costs must be allocated on the assessment base.

We acknowledge as the appellant points out that the CAS 403 allocation is but an intermediate step in properly

allocating cost to final cost objectives. We, too, agree that it must be in accordance with beneficial or causal relationships. However, while the appellant thinks it is not, we believe it is as we understand CAS 403.

### Summary

This is a case of first impression and it was extensively litigated. In an effort to set forth the appellant's position and its factual premise and to respond to its numerous arguments, the opinion has been rather extended. A summary of the Board's views is appropriate.

When this Board first considered the allocability of the taxes here involved, the Armed Services Procurement Regulation then in effect, as construed by the Court of Claims in *Lockheed Aircraft Corp. v. United States*, 179 Ct. Cl. 545, 375 F.2d 786 (1967), established a broad test of benefit into which all state and local taxes fell, unless specifically excluded. Allocation to cost objectives, such as a contract, could be made on any reasonable basis. ASPR 15-201 and 15-203 (1959-1962). This board held that these taxes were properly chargeable to Boeing's company overhead under this broad benefit theory, and that the employee head count method was a reasonable basis of allocation of these costs to the appellant's operating divisions or segments. *Boeing Company*, ASBCA 11866, 69-2 BCA par. 7898, affirmed *Boeing Company v. United States*, 202 Ct. Cl. 315, 480 F.2d 854 (1973). In reaching the latter conclusion, the board necessarily assumed that the benefit from these taxes cannot be measured directly to particular cost objectives; thus a surrogate, such as the head count, must be used.

CAS 403 established new tests for the allocation of home office expenses to segments. These are founded upon the principle that, to the maximum extent practical, such expenses are to be identified and allocated directly to the individual segments. Where direct identification is impractical, such costs are to be accumulated in logical and relatively homogeneous pools to be allocated on bases reflecting the relationship of the expenses to the segments concerned. Only if neither of the foregoing criteria can be

met is there to be a residual expense pool to be allocated to all segments. CAS 403.20.

In the operative regulation, to carry the foregoing statement of policy into effect, the element of causality was added to the test. CAS 403.40 does not accept the broad benefit test of the prior ASPR, under which the board and the court approved the appellant's head count method of allocating state and local taxes. Where types of costs such as these taxes are accumulated and paid by the home office, they are to be allocated to segments by either specific identification, or if this cannot be done on the basis of causality; that is, by using an allocation base representative of the factors on which the total payment is based. Applied to the taxes here considered this means the basis upon which the taxes were assessed.

The appellant would attack the application of the Cost Accounting Standard to its own treatment of state and local taxes on two bases, other than interpretation. It says that it could easily avoid the standard by having its Seattle Services Division, instead of the corporate home office, accumulate and pay the taxes; thus form should not prevail over substance. The short answer to this is that a segment for certain functions may be a home office for others. CAS 403.30(2).

The second of these arguments is that is unfair to use the assessment base method to charge to Boeing Aerospace Company, for example, all of the taxes on a plant facility which is shared in use by the Boeing Commercial Airplane Company, merely because the Boeing Aerospace Company is assigned responsibility for that plant in a given fiscal year. This is a matter of internal management. If the appellant can devise a better method of space or use assignment to its segments, there appears to be nothing in the standard to prevent its use. For purposes of this appeal, we must take the appellant's internal management as we find it.

The assessment base method of allocation of state and local taxes is consistent with CAS 403. The appellant's head count method is not.

We conclude that each of the taxes here in issue, except the Renton tax, can be specifically identified with an individual segment according to the assessment base of each tax and, therefore, according to CAS 403(b)(4), should be allocated directly to that segment. The Renton tax should be allocated to the segments with employees in Renton on the basis of the proportion of each segment's employees in Renton to the total number of employees in Renton. That is using a base representative of the factors (head count) on which the total Renton tax is based.

The appeal is denied.

Dated 18 February 1977.

s/Talbot J. Nicholas

TALBOT J. NICHOLAS, LT.  
COL., JAGC  
Administrative Judge  
Member pro-tem of Division  
No. 3,  
Armed Services Board of  
Contract Appeals

*I concur*

s/Joseph M. Cowden, Jr.

JOSEPH M. COWDEN, JR.  
Administrative Judge  
Member of Division No. 3,  
Armed Services Board of  
Contract Appeals

*I concur*

s/John J. Norman

JOHN J. NORMAN  
Administrative Judge  
Member of Division No. 3,  
Armed Services Board of  
Contract Appeals

ALAN M. SPECTOR  
Administrative Judge  
Member of Division No. 3,  
Armed Services Board of  
Contract Appeals did not  
participate in the consideration or  
decision of this appeal.

*I concur*

s/Richard C. Solibakke

**RICHARD C. SOLIBAKKE**  
Administrative Judge  
Chairman, Armed Services Board  
of Contract Appeals

*I concur*

s/Harris J. Andrews, Jr.

**HARRIS J. ANDREWS, JR.**  
Administrative Judge  
Vice Chairman, Armed Services  
Board of Contract Appeals

I certify that the foregoing is a true copy of the decision and opinion of the Armed Services Board of Contract Appeals in ASBCA No. 19224, Appeal of The Boeing Company, rendered in conformance with the Board's Charter.

Dated: 24 Feb 1977

s/George L. Hawkes

**GEORGE L. HAWKES,**  
Recorder  
Armed Services Board of  
Contract Appeals



## APPENDIX C

### ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeal of—

The Boeing Company

Under Contract No. F33-657-73-C-0257 )

)  
) ASBCA No. 19224  
)

APPEARANCES FOR THE  
APPELLANT:

Harold F. Olsen, Esq.  
Graham H. Fernald, Esq.  
Perkins, Coie, Stone, Olsen  
and Williams  
Seattle, Washington

APPEARANCES FOR THE  
GOVERNMENT:

Colonel John T. Murphy, USAF  
Chief Trial Attorney  
William S. Merrell, Esq.  
Trial Attorney

### ON MOTION FOR RECONSIDERATION

The appellant has filed a motion for reconsideration of our decision in this appeal. (77-1 BCA ¶12,371). Having considered the parties' briefs, oral argument and supplemental written argument we affirm our decision.

This case required the Board to interpret for the first time the provisions of Cost Accounting Standard (CAS) 403 governing the allocation of home office expenses to segments. This Standard provided explicit treatment of this matter for the first time. The ASPR cost principles which had governed the matter of cost allocation had not dealt with this problem specifically.

The cost being allocated are taxes paid by the appellant to various taxing jurisdictions in the State of Washington. They include Real Property taxes, Personal Property taxes, Sales and Use taxes, Business and Occupation taxes and Fuel and Vehicle taxes.

The appellant through its internal accounting determines from each of its segments the tax cost each incurs on an assessed basis. These amounts are transferred to a home office account. The appellant then allocates these home office expenses to each segment on the basis of that segment's headcount as a proportion of the total headcount of the segments.

A consequence of the appellant's allocation method is that the amount of tax allocated to the segment, Boeing Aerospace Company (BAC), which had responsibility for the contract under which this appeal was brought was greater than it would have been if the allocation had been made on the basis of the assessment base of the tax. That this consequence ensued was not disputed.

The parties were in agreement that CAS 403.40(b)(4) controlled the question. It reads:

*"(4) Central payments or accruals. Central payments or accruals which are made by a home office on behalf of its segments shall be allocated directly to segments to the extent that all such payments or accruals of a given type or class can be identified specifically with individual segments. Central payments or accruals are those which but for the existence of a number of segments would be accrued or paid by the individual segments. Common examples include centrally paid or accrued pension costs, group insurance costs, State and local income taxes and franchise taxes, and payrolls paid by a home office on behalf of its segments. Any such types of payments or accruals which cannot be identified specifically with individual segments shall be allocated to benefited segments using an allocation base representative of the factors on which the total payment is based."*

The Government contended that the taxes paid by appellant could be identified specifically with each of appellant's segments by the assessment base of the tax. The appellant did not disagree with that proposition. Rather, the appellant contended that such an allocation did not distribute the costs to each segment in accordance with the benefits received by the segment.

The appellant contended that the benefit received by the segments was the community services funded with the taxes paid. The Government did not deny that the segments received benefits from the community services.

The appellant also contended that the cause of the taxes was the communities' need for the community services. The

Government agreed that *a* cause of the taxes is the community need for services, but contended the relevant cause of the tax cost to the appellant was the existence of the various assessment bases upon which appellant's tax payment is based. The appellant did not disagree that a form of causal relationship existed between the assessment base and the tax, but contended that that was not the causal relationship referred to by CAS 403.

In our decision we agreed with the parties that all but one of the taxes paid by appellant could be identified specifically with each segment. The Renton tax, because it was based, on a graduated scale, upon the number of the firm's employees who perform any or all of their duties within that city, could not be identified specifically with a particular segment.

We concluded that CAS 403.40(b)(4) required those tax costs which could be identified specifically with an individual segment to be allocated directly to that segment. The Renton tax cost we concluded, according to the same section, should be allocated to the individual segment on a base representative of the factor upon which that tax is based. The factor upon which that tax is based being Renton headcount, the allocation to each segment should be based on its proportionate share of the total Renton headcount.

While we recognized that in a sense (from the point of view of the taxing jurisdiction) it might be said that the need for community services is *a* cause of the tax and that the appellant receives *a* benefit from the services provided by the community, we concluded these were not the referents of the CAS 403 allusion to beneficial and causal relationships. Rather, we were convinced that CAS 403 treated the relevant cause of a tax cost (from the point of view of the corporation) as the existence of those factors upon which the tax is based, i.e. the assessment base.

Although CAS 403 does not explicitly address the allocation of the cost of the particular taxes in issue here, we found their concept of cause and benefit as it pertains to tax costs illustrated in its treatment of State and Local Income taxes and Franchise taxes. We noted that the CAS Board had in its exposure draft of CAS 403 required the

allocation of such taxes to segments on the basis of the income or loss of such segments. This the appellant asserted was an "assessment base" approach and we agreed. We considered the utilization of such an approach at that stage as indicative of the CAS Board conclusion that such an approach is consistent with its concept of a causal or beneficial relationship and indicative of the CAS Board's looking away from community services as the benefit received by the segment.

The final version of CAS 403 changed the allocation base from "income or loss of such segment" to:

"any base or method which results in an allocation that equals or approximates a segment's proportionate share of the tax imposed by the jurisdiction in which the segment does business, as measured by the same factors used to determine taxable income for that jurisdiction."

We considered the selection of the factors used by the taxing jurisdiction to apportion corporate wide Unitary income to the taxing jurisdiction, that is, to determine taxable income for that jurisdiction, indicated the CAS Board's continued focus on an assessment base approach. We noted the fact that various states, rather than utilize the income reflected on the books of a segment, prefer to determine state taxable income by apportioning total corporate income to the state by the use of more objectively measurable factors such as payroll, property and sales in the state in relation to total corporate payroll, property and sales.

The appellant's contention in its broadest aspect is that our decision as a matter of law incorrectly interpreted CAS 403.40(b)(4) as applied to the allocation of Boeing's Washington State and local taxes to Boeing's business conducted in the State of Washington and that the decision is not supported by substantial evidence. The appellant makes three arguments, as follows:

"The ASBCA should reconsider and reverse or modify its decision for the following reasons:

"1. By interpreting CAS 403 as mandatorily requiring the allocation of any central payment or accrual to a single segment merely because it can be 'identified specifically' to that segment by mechanical traceability without regard to any facts or circumstances, the decision is clearly erroneous as a matter of law.

"2. By holding that CAS 403.40 'does not accept the broad benefit test' and that costs such as Boeing's taxes which are paid by a home office must be allocated to segments by 'either specific identification or, if this cannot be done, on the basis of causality,' and thus giving no effect to the words 'benefit,' 'beneficial' and 'benefited' appearing in the Standard, the decision is clearly erroneous as a matter of law.

"3. The decision as it relates specifically to the allocation of Boeing's Washington state and local taxes to the business conducted by Boeing in the State of Washington is not equitable, is not supported by any findings of fact, nor is there any substantial evidence in the record to support the decision. On the contrary, there is ample evidence in the record to support a finding of fact that Boeing's method of allocating its taxes is equitable and the ASBCA has found as a fact (p. 44) that Boeing's method allocates its tax costs in accordance with both a beneficial and a causal relationship."

Each of these contentions is further amplified in appellant's brief. We will deal with them seriatim.

The essence of appellant's first argument is that we focused too narrowly upon the first sentence of CAS 403.40(b)(4) with the result that we interpreted the standard as a "mandatory" rule which calls for the application of "rigid simplistic accounting methods" to effect a more "mechanical" traceability to identify specifically a tax with a segment. Thus, it contends, we misinterpreted the CAS Board intention which is to provide "criteria" and "standards" and to provide for "flexibility rather than rigidity."

The appellant points to certain language as supportive of its view. For example, Section 403.20, Purpose, provides:



"(a) The purpose of this Cost Accounting Standard is to establish criteria for allocation of the expenses of a home office to the segments of the organization based on the beneficial or causal relationship between such expenses and the receiving segments."

This, it argues demonstrate "CAS 403 is not designed to specify any mandatory rule or method." Further, it is argued that the CAS Board's Statement of Operating Policies Procedures and Objectives "is contrary to the conclusion reached by the Board in that it explains that a cost accounting standard is a statement

'[T]hat (1) enunciates a principle or principles to be followed, (2) establishes practices to be applied, or (3) specifies criteria to be employed in selecting from *alternative* principles and practices in estimating, accumulating and reporting costs of contracts subject to the rules of the Board.'

[Emphasis supplied.]"

Further, noting our consideration of the fact that CAS 403 sets forth a three tier preferential hierarchy of allocation methods, the first preference being direct allocation of costs, the appellant argues that the same Policy Statement "carefully conditions this preference as follows:

'As an ideal, each item of cost should be assigned to the cost objective which was *intended to benefit from the resource represented by the cost or, alternatively, which caused incurrence of the cost.* To approach this goal, the Board believes in the desirability of direct identification of costs with final cost objectives to the extent practical. The Board recognizes the need for care in application of the concept of direct identification of costs with final cost objectives. Therefore, Cost Accounting Standards developed by the Board will reflect the desire for direct identification of cost and at the same time provide safeguards (such as those of 4 CFR 402) to assure consistency and objectivity in allocating costs incurred for the same purpose.'

[Emphasis supplied.]"

From this appellant argues that:

"Thus, direct identification of the cost to a segment by a mechanical means is not enough. For direct identification to lead to direct assignment to a segment, that segment must be *the only* 'cost objective' intended to be benefited 'from the resource represented by the cost' or, *alternatively*, it must be *'the cost objective . . . which caused incurrence of the cost.'* [Emphasis supplied.]"

These arguments do not persuade us that we erred. The Standards contain a wide range of rules, some quite general and some quite particular. As the Policy Statement itself points out, a standard may contain "principles"; it may "establish practices"; and it may specify "criteria" for selecting between various principles and practices. We perceive little virtue in trying to label any sentence "criteria", "principle" or "practice". Neither do we find such appellations as "mechanical" or "rigid" as helpful in resolving the interpretive problem. In the search for the CAS Board intent we did not overlook the more general statements that may be found in the standard but neither did we ignore the more particular language used with respect to the allocation problem most clearly analogous to that before us, that is, the particular treatment of taxes.

The appellant's argument that the Policy Statement carefully conditions the utilization the first preference in the hierarchy, i.e. direct allocation, has two aspects. The "safeguards" alluded to therein, such as found in CAS 402, are designed to avoid a particular cost being allocated directly to a cost objective as a "direct cost" and also allocated from a cost pool as an "indirect cost." CAS 402.20, Purpose, explains:

"The purpose of this standard is to require that each type of cost is allocated only once and on only one basis to any contract or other cost objective. The criteria for determining the allocation of costs to a product, contract, or other cost objective should be the same for all similar objectives. Adherence to these cost accounting concepts is necessary to guard against the overcharging of some cost objectives and to prevent double counting. Double counting occurs most commonly

when cost items are allocated directly to a cost objective without eliminating like cost items from indirect cost pools which are allocated to that cost objective."

As to this aspect of appellant's argument we do not conceive of the safeguards as designed to restrict the use of the first preference, i.e. direct allocation. Rather they seek to preclude double counting. So far as we can perceive a direct allocation of a particular tax cost to a segment on the basis of the tax assessment base would not involve double counting so long as the same tax cost was not retained in a pool and again allocated to the segment from that pool. The same safeguard is provided in CAS 403 itself. CAS 403.40(a)(2) provides:

"No segment shall have allocated to it as an indirect cost, either through a homogenous expense pool, or the residual expense pool, any cost, if other costs incurred for the same purpose have been allocated directly to that or any other segment."

The other aspect of appellant's argument from this Policy Statement is that the direct allocation of a tax cost to a segment does not follow from specific identification of the cost to the segment (as by the assessment base of the tax) because "that segment must be *the only* 'cost objective' intended to be benefited 'from the resources represented by the cost' or alternatively, it must be *the* cost objective . . . which caused incurrence of the cost' ". (Emphasis is appellant's)

It may be seen that the appellant's premise is that all of its tax costs are intended to benefit all of its segments with the resources (community services) the taxes ultimately go to pay for. This is what we conceive of as the basic fallacy of appellant's position. We shall say more about it later. However, we may note here that a particular segment may well be understood as the cost objective which causes the incurrence of the particular tax cost. To speak of a cost objective (segment) causing the incurrence of a cost seems to refer to the fact that a segment is responsible for the performance of the work which causes the cost to be incurred. It is in this sense that we understand a cost objective causing the incurrence of a cost.

In further support of its first argument the appellant points to other sections of CAS 403 and to other Standards, CAS 410 and 413.

The appellant notes that "flexibility" is provided by CAS 403.60 illustrating for each type of home office expense a number of acceptable allocation bases. It points out that the provisions respecting "Residual expense" allocation provide for flexibility particularly in situations where there is an indication that a "segment received significantly more or less benefit from residual expenses" than would be reflected by an allocation of such expenses pursuant to the three factor formula set forth at 403.50(c)(i). In such situations CAS 403.40(c)(3) permits the contractor and the Government to "agree to a special allocation of residual expenses to such segment commensurate with the benefits received."

That such provisions respecting "residual" expenses were deemed necessary by the CAS Board is of no particular help to appellant's argument. These are expenses which the Standard itself - by its rules for first and second preference allocations - seeks to minimize and restrict to the expenses of managing the organization as a whole. (CAS 403.20(a)) They are expenses which generally may not be specifically identified with a particular segment so as to permit direct allocation, or even "identifiable with specific activities of segments" so as to be allocable from a homogenous pool on bases reflecting the relationship of the expenses to the segments concerned. (CAS 403.20(a)(2); 403.40(c)(i)) The CAS Board's provision for a way to account for those situations where there are indications that an allocation of residual expenses by the three factor formula would charge a segment with more or less of such costs than corresponds to the benefit the segment receives from the expenditure of such costs does not suggest that those other costs which properly lend themselves to treatment under the first or second preferential methods of allocation should not be allocated thus.

The appellant argues that the CAS Board has given further indication that "flexibility" rather than "rigidity" is required by its treatment of another "central payment and accrual" e.g. Pension costs. (CAS 403.40(b)(4)) CAS 403.60(b)

illustrates as allocation bases for pension costs "Payment or other factor on which total payment is based." Appellant states:

"However, in CAS 413, a Standard dealing specifically with allocation of pension costs and published subsequent to CAS 403, the CAS Board states that pension costs shall be allocated on a payroll base which is in effect an assessment base but that 'the contracting parties may agree to the use of any other allocation base if such other base established a beneficial or causal relationship between the segments and the pension cost' (CAS 413.50(c)(1)). Thus, even though the 'assessment' base is a method described in CAS 403 and available under CAS 413, the CAS Board recognizes that it is proper and acceptable that the parties may use 'any other allocation base' if such base is in accordance with beneficial and causal relationships."

The language the appellant quotes is actually found in a *proposed* Standard (Vol. 42 Federal Register 6594, 3 Feb. 1977)\* in existence on 6 May 1977 when appellant submitted its brief on the motion for reconsideration. On 20 July 1977 the CAS Board published the Standard (42 Federal Regulation 37196) and deleted the language upon which appellant relies. Nonetheless, the CAS Board treatment of Pension costs is somewhat instructive. Not only did the CAS Board utilize an assessment base for allocating this cost but required the

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\* The full text of the proposed section read as follows:

"(c) *Allocation of pension cost.* (1) For contractors who compute a composite pension cost covering plan participants in two or more segments, the allocation of pension cost to such segments shall be made on the following bases. For a plan whose benefits are based on salaries and wages, the pension cost shall be allocated to each segment on the basis of the salaries and wages for the participants of the segments. For a plan whose benefits are not based on salaries and wages, the pension cost shall be allocated to each segment on the basis of the number of participants in the segments. However, the contracting parties may agree to the use of any other allocation base if such other base establishes a beneficial or casual [sic] relationship between the segments and the pension cost.



contractor to calculate separately a segments cost under certain circumstances. (CAS 413.50(c)(2) and (3)).\*\*

The CAS Board's "Promulgation Comments" which accompany the standard in the Federal Register explain that:

"Normally, pension costs are 'central payments or accruals' as that term is used in 4 CFR Part 403. Therefore, where pension costs can be computed for an individual segment, 4 CFR 403 would ordinarily require that the amount so computed be the amount allocated to such segment. The calculation of individual segment costs is, in effect, a direct allocation which is not only consistent with CAS 403, but is also consistent with the Board's cost allocation concepts as set forth in the Board's Restatement of Objectives, Policies and Concepts. (May 1977)"

From this it would appear evident that the CAS Board treatment of pension cost is consistent with our conclusion as to its intention with respect to tax costs. That is, where they can be computed for an individual segment they would be directly allocated to that segment.

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\*\* (c) Allocation of pension cost to segments.

"(2) Separate pension cost for a segment shall be calculated whenever any of the following conditions [sic] exist for that segment, provided that such condition(s) materially affect the amount of pension cost allocated to the segment: (i) There is a material termination gain or loss attributable to the segment, (ii) The level of benefits, eligibility for benefits, or age distribution is materially different for the segment than for the average of all segments, or (iii) The appropriate assumptions relating to termination, retirement age, or salary scale are, in the aggregate, materially different for the segment than for the average of all segments. Calculations of termination gains or losses shall give consideration to factors such as unexpected early retirements, benefits becoming fully vested, and reinstatements or transfers without loss of benefits. An amount may be estimated for future re-employments.

"(3) Pension cost shall also be separately calculated for a segment under circumstances where (i) The pension plan for that segment becomes merged with that of another segment, and (ii) The ratios of assets to actuarial liabilities for each of the merged plans are materially different from one another after applying the benefits in effect after the merger."

With respect to pension costs, however, the CAS Board, recognizing that there is additional cost to the company in making the calculation of a separate pension cost, does not require it unless the allocation resulting from a separate calculation would differ materially from the results of using an allocation base. The CAS Board stated:

"[T]he Board recognizes that the calculation of separate segments Pension costs can not be made without some additional cost and effort. Consistent with its long-standing concepts on materiality, the Board believes that the calculation of separate segment pension cost should be mandatory only when such separate calculations produce materially different results than would result from the use of an allocation base."

The additional cost involved in making the calculations needed for a direct allocation approach with respect to pension costs has caused the CAS Board to reverse the preference as to allocation method from the preference found in CAS 403. In other words, rather than requiring the direct allocation of separately-calculated segment pension costs to each segment as a first preference, and as a second preference calling for the distribution of a pool of segments' pension costs to segments on a base "representative of the factors [on] which the pension benefits are based", e.g. "salaries and wages" or "number of employees" (CAS 413.50(c)(2)), the CAS Board prescribed the distribution by use of an allocation base unless the (more costly) use of a direct allocation approach would result in materially different costs allocation to a segment.\*

We do not consider the CAS Board's treatment of pension costs supportive of appellant. Rather it tends to reflect the fact that CAS Board looked to an assessment base as the

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\* The CAS Board's Promulgation comment indicates it believes it would not be necessary to perform the separate calculations in order to determine whether there would be a material difference since "it will be obvious to the contracting parties whether the presence of one or more of the conditions [for making a separate calculation] for a segment will materially affect the pension cost for that segment."

basis for allocation there as well. Further it tends to suggest that the Board would treat as mandatory the direct allocation of such costs as could be separately calculated for a segment in accordance with CAS 403, except for the fact that CAS 413 reverses the preference for direct allocation because of the additional cost included in making the separate calculations needed for a direct allocation. Thus, the treatment of pension costs actually tends to be supportive of our decision.

The appellant refers us to the CAS Board's treatment of the allocation of Business Unit General and Administrative Expenses to Final Cost objectives as further indication of its intention that CAS 403 not be interpreted "so rigidly and mechanically".

CAS 410 governing the allocation of Business Unit G & A to Final Cost Objectives was published on 16 April 1976 (41 FR 16141). It covers the allocation of Business Unit (segment) G&A and the allocation by the segment of those home office expenses allocated to the segment. We find it consistent with the CAS Board's treatment of the allocation of home office expenses, in particular taxes.

The heart of appellant's argument is as follows:

"CAS 410.50(g) demonstrates this CAS Board objective, by providing that home office expenses 'shall be allocated to the segment cost objectives in proportion to the beneficial or causal relationship between the cost objectives and the expense . . .'. The allocation base may be any one of several alternatives, but the determination as to which base is to be used 'must be judged on the basis of the circumstances of each business unit.' (CAS 410.50(d).) If a particular final cost objective 'receives significantly more or less benefit from G&A expense than would be reflected by' the allocation base suggested in the Standard, then there shall be 'a special allocation from the G&A expense pool to the particular final cost objective commensurate with the benefits received.' (CAS 410.50(j).)

"This flexible treatment, designed to reflect the circumstances or reasons for the incurrence of a

cost, demonstrates that cost allocation is intended by the CAS Board to be determined in a sensible and logical manner, not on mere traceability. It is inconceivable that the same attention to the beneficial relationship should not be given to assigning costs from headquarters to segments."

The foregoing parsing of regulation is of little help to appellant. Indeed, when the context of CAS 410 is considered, we believe it consistent with, and supportive of, our interpretation of CAS 403.

The stated purpose of CAS 410 is as follows:

**"§410.20 Purpose.**

**"The purpose of this Cost Accounting Standard is to provide criteria for the allocation of business unit general and administrative (G&A) expenses to business unit final cost objectives based on their beneficial or causal relationship. These expenses represent the cost of the management and administration of the business unit as a whole. The Standard also provides criteria for the allocation of home office expenses received by a segment to the cost objectives of that segment. This Standard will increase the likelihood of achieving objectivity in the allocation of expenses to final cost objectives and comparability of cost data among contractors in similar circumstances."**

**G&A expense is defined as follows: (CAS 410.30(a)(6))**

**"(6) General and Administrative (G&A) expense. Any management, financial, and other expense which is incurred by or allocated to a business unit and which is for the general management and administration of the business unit as a whole. G&A expense does not include those management expenses whose beneficial or causal relationship to cost objectives can be more directly measured by a base other than a cost input base representing the total activity of a business unit during a cost accounting period."**

At this point it may be seen that the CAS Board distinguishes between the segment's G&A and that portion of home office expense allocated to the segment pursuant

to CAS 403. Further, it may be seen that it intends even segment G&A to be allocated to final cost objective be restricted to those expenses which may be related to a cost objective more directly than by the cost input base it prescribes for the allocation of segment G&A. Thus, the CAS Board desire for application of more objective measurement of amounts to be allocated is manifest.

CAS 410.40 requires segment G&A expenses to be grouped in a separate pool to be allocated to final cost objectives on a "cost input" base\* representing the total activity of the segment unless it should receive a special allocation under CAS 410.50(j) which reads:

"(j) Where a particular final cost objective in relation to other final cost objectives receives significantly more or less benefit from G&A expense than would be reflected by the allocation of such expenses using a base determined pursuant to paragraph (d) of this section [Cost input] the business unit shall account for this particular final cost objective by a special allocation from the G&A expense pool to the particular final cost objective commensurate with the benefits received. The amount of a special allocation to any such final cost objective shall be excluded from the G&A expense pool required by section 410.40(a), and the particular final cost objective's cost input data shall be excluded from the base used to allocate this pool."

The CAS Board "Promulgation Comment" explains that such a special allocation would be justified only by a contract

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\* CAS 410.50(d) describes three possible "cost input" bases: a total cost input base, a value-added cost input base, and a single element cost input base, e.g. direct labor dollars or hours. The language appellant excepts from that section pertains to the selection of the cost input base. It reads in full "The determination of which cost input base best represents the total activity of a business unit must be judged on the basis of the circumstances of each business unit [segment]." This search for the best cost input base pertains to the allocation of the segment's G&A which by operation of CAS 410.50(g) would not include all of home office expenses.



or other final cost objective which is an exception to a segment's normal operation. It states:

#### **"6. ALLOCATION OF G&A EXPENSES TO SPECIAL CONTRACTS**

**"Commentators suggested that the special allocation provision be stated in terms of class of contracts or types of situations. If the G&A expense pool meets the requirements of the Standard, the existence of a need for special allocation to a class of contracts or type of situation would indicate that the allocation base being used is not representative of the total activity of the business unit during a typical cost accounting period. The Standard is designed to provide consistent accounting treatment for all contracts, except for a particular contract or other final cost objective which is an exception to a business unit's normal operation.**

**"The cost input allocation base for G&A expense is a broad measure which is normally representative of the total activity of a business unit during a cost accounting period. Thus, for a given final cost objective to qualify for special treatment, the difference in its beneficial or causal relationship to G&A expense as compared with the relationship of other final cost objectives to G&A expenses should be one which is apparent and capable of being supported. The provision of the Standard calls for the exercise of judgment; nonetheless, the Board believes a materiality criterion based on a measure of significantly different benefits is proper for use in evaluating and establishing a separate and exceptional allocation to a given final cost objective."**

While this treatment may be said to reflect the CAS Board's interest in "flexibility" it also reflects the Board's interest in using a base for allocation which most specifically identifies a cost with a cost objective.

Its treatment of a segment allocation of Home Office expenses conveys a similar message. Home office expenses allocated to the segment are to be allocated to the segment's cost objectives as required by CAS 410.50(g). It reads:

**“(g) (1) Allocations of the home office expenses of (i) line management or particular segments or groups of segments, (ii) residual expenses, and (iii) directly allocated expenses related to the management and administration of the receiving segment as a whole shall be included in the receiving segment’s G&A expense pool.**

**“(2) Any separate allocation of the expenses of home office (i) centralized service functions, (ii) staff management of specific activities of segments, and (iii) central payments or accruals; which is received by a segment shall be allocated to the segment cost objectives in proportion to the beneficial or causal relationship between the cost objectives and the expense if such allocation is significant in amount. Where a beneficial or causal relationship for the expense is not identifiable with segment cost objectives, the expense may be included in the G&A expense pool.”**

The parallel between the types of Home Office expenses set out above and those set forth in CAS 403.40 is obvious. The central payments or accruals allocated to the segment may have been a result of direct allocation or by proration over an allocation base. The further allocation of these costs by the segment to its cost objectives shall be “in proportion to the beneficial or causal relationship between the cost objectives and the expense” if the amount is significant. However, the Standard goes on: “When a beneficial or causal relationship for the expenses is not identifiable with segment cost objectives, the expenses may be included in the G&A expense pool.” We understand the CAS Board’s treatment of these expenses as reflecting its intention that their allocation be on a base that best identifies them with the segment’s cost objective. Certain items may be allocated on one of the three cost input bases. These are such as are not identifiable with the segment’s cost objectives. Those expenses that can be identified with the segment cost objective are to be allocated to those cost objectives. This treatment is consistent with the treatment of the allocation of Home Office expense to segments as prescribed by CAS 403.

Appellant argues that CAS 410 reflects the CAS Board's attention to the beneficial relationship between a segment cost and cost objective and that it is inconceivable that similar attention was not given it in CAS 403, implying that our decision overlooks that fact. We believe CAS 410 does reflect the CAS Board's attention to both beneficial and causal relationship between segment costs and segment cost objectives and we believe that it was concerned with these relationships in CAS 403. Our decision does not suggest the contrary. However, it is equally clear to us that the CAS Board's treatment of tax cost allocation reflects its conclusion that an allocation of tax costs on the assessment base or any method not producing significantly different results does effect an allocation according to its concept of beneficial or causal relationship between the cost and the segment.

In short, we are unable to see any inconsistency between our understanding of the CAS Board's approaches in CAS 403 and CAS 410.

In its Argument 2 appellant contends we violated the cardinal rule for interpreting a document; that it be read as a whole. Although the CAS Board uses the word "benefit", "beneficial" or "benefitted" eighteen times in the Standard and its prefatory comment, appellant contends, our conclusions that the CAS Board "does not accept the broad benefit test" and that "if a cost cannot be allocated to a segment by specific identification, then it *must be* done on the basis of *causality*", (emphasis appellant's) fails to consider these words. Appellant contends the Boards [sic] decision was "based solely and squarely on its interpretation of the first sentence of CAS 403.40(b)(4) . . . regardless of the facts and circumstances which may clearly establish that such allocation is inequitable."

Appellant complains that our conclusion that the taxes could be "identified specifically" with the segments seems to be based on a causal relationship only and fails to consider the beneficial relationship although under the standard "identification may be by *either a beneficial or a causal relationship*" and that "the greater emphasis throughout the Standard seem [sic] clearly to be on benefit." (Emphasis

appellant's) The appellant points to the evidence and our findings that there is a benefit received by the segments from the taxes paid. The taxes paid "are corporation costs paid for community services that benefit all of Boeing business conducted in Washington. None of such tax costs representing community services provided by the taxing jurisdiction (the 'resource represented by the cost' (Policy Statement)) can be 'identified specifically' to any one segment for direct assignment."

The appellant also takes exception to our finding support in the CAS Board's treatment of State income taxes. It believes that treatment supports its view of CAS 403. It says:

"[A]s to state income taxes, CAS 403 again only instructs that such taxes be assigned to the segments (again plural) in the state where the tax is paid. It does not then instruct or even suggest that if there are two or more segments in one state, any of such taxes can be identified specifically to or directly assigned to any *one* of the segments within the state. CAS 403 does in the illustration section suggest that such taxes be allocated on 'any base or method which results in an allocation that *equals or approximates* a segment's proportionate share of the tax imposed by the jurisdiction in which the segment does business as measured by the same factors used to determine taxable income for that jurisdiction.' (Emphasis supplied.) But, of course, CAS 403.60(c) goes on to say that the listed allocation bases are illustrative only and that other allocation bases may be used if they are substantially in accordance with the beneficial or causal relationship outlined in CAS 403.40.

"The treatment accorded state income taxes thus supports Boeing's position that any tax that benefits two or more segments must be allocated proportionately to all benefited segments rather than the conclusions of the decision that each type tax must be allocated solely to the segment where the property or transaction is located."

The appellant's arguments lack merit. A reading of the Standard as a whole led us to the conclusion that the CAS Board had rejected the broad benefit test under which

appellant's headcount method of allocating these taxes had been deemed acceptable. The broad benefit test was announced by the Court of Claims in *Lockheed Aircraft Corp. v. United States*, 179 Ct. Cl. 545, and permitted looking to the benefits received from the community services as the benefit to be measured by the allocation of tax costs. Our conclusion was reached not by ignoring the CAS Board's frequent allusion to the benefits received by a segment but by considering its use of the words generally and particularly in the context of its treatment of taxes. There is no dispute that the assessment base of a tax does not measure the benefits received from community services. Thus, our conclusion that the CAS Board had prescribed an allocation on an assessment base which allocation base it deemed consistent with its concept of beneficial and causal relationship, compelled a conclusion that its concept did not include the measurement of the benefits received from community services. Furthermore, though we pointed out that such an allocation may be viewed as being based on causality, we also noted that the segment may be viewed as receiving the benefit of the home office having paid the tax.

While we did consider the allocation of each of the taxes except the Renton tax as falling within the purview of the first sentence of CAS 403.40(b)(4), it is inaccurate to characterize our conclusion as being based "solely" on that. That sentence is a part of the Standard which was considered as a whole. That sentence we concluded was in harmony with the scheme of the Standard read as a whole. The appellant's assertion that we ignored the facts and circumstances that "may clearly establish that such an allocation is inequitable" is merely an assertion that an allocation on a basis that does not treat the community services received by appellant as *the* benefit to be measured is an improper base and thus inequitable. The appellant does not explain how the selection of a base (headcount) which has no correlation to the tax cost produces an equitable result. We surmise its logic derives from the fact that the Court of Claims, interpreting ASPR 15-201.4, permitting allocation of costs to "a particular cost objective . . . . in accordance with the relative benefits received or other equitable relationship", concluded that the



benefits received may be viewed as the community services received which were funded with the tax receipts. Appellant thus infers that whatever allocation base was approved under such a theory produces an equitable result.

As we noted in our initial opinion, the adequacy of this broad benefit concept for the allocation of income tax has been questioned. (Pg. 46) In any event, there is no denying that the CAS Board was concerned with the equity produced by allocations. Indeed, as it pointed out in the "Promulgating Comments" accompanying the promulgation of CAS 403, the "Work on this Standard was initiated as a result of a variety of continuing problems between contractors and the Government concerning *equitable* allocation of home office expenses to segments . . . ." (Emphasis added). Thus, we infer that the CAS Board's conclusion as to the proper allocation base to use was a reflection of its conclusion that equitable allocations would be produced thereby. The appellant does not demonstrate that the result obtained is inequitable. It only demonstrates it is different from that result obtained by its method and then labels it inequitable. We are unimpressed by such circular reasoning.

The appellant's contention that the CAS Board's treatment of State Income taxes supports its position flies in the face of the Standard's language. Appellant acknowledges the language of CAS 403.60 that any allocation base used must result "in an allocation that equals or approximates a segment's proportionate share of the tax imposed by the jurisdiction in which the segment does business as measured by the same factors used to determine taxable income for the jurisdiction." It tosses this off as "illustrative only" pointing out that other allocation bases may be used if substantially in accord with the beneficial or causal relationship outlined in CAS 403.40. Its headcount method it urges is such an other base. We do not believe it rational to conclude that the CAS Board contemplated the substitution of a base its proponent urges as a surrogate for determining the tax-funded community service benefits received by a segment, in lieu of a base that measures of segment's share of the tax cost by the segment's share of

the factors used to determine taxable income and admittedly does not measure community service benefits. As we indicated earlier, the selection of a base that focuses upon the factors used by the state to apportion corporate wide income to determine state taxable income is the affirmation of an assessment base approach which is a rejection of that concept of beneficial or causal relationships inherent in the appellant's use of a headcount base as a surrogate for measuring benefits received from community services.

The appellant argues that the Standard's treatment of State Income taxes "does not instruct or even suggest that if there are two or more segments in one state, any of such taxes can be identified specifically to or directly assigned to any one of the segments". We disagree.

CAS 403.40(b)(4) plainly treats "State and local income taxes and franchise taxes" as central payments or accruals to be directly allocated to individual segments so far as they may be specifically identified with individual segments. It goes on to point out that "any such type of payment or accruals which cannot be identified specifically with individual segments shall be allocated to the benefited segments using an allocation base representative of the factors on which the total payment is based". CAS 403.60 then illustrates some "typical pools" and for a "State and local income and franchise tax" pool it sets forth appropriate criteria for determining whether any allocation base is acceptable, namely whether it produces results equaling or approximating the segment's proportionate share of the tax as measured by the same factors used by the taxing jurisdiction to determine taxable income. The CAS Board's "Promulgation comment" explains that:

*"As a practical matter, this means that the tax for any State must be allocated only to those segments that contribute to the factors used to measure taxable income for that State. If there are several segments that do business within a State, each segment's share of that State's tax is to be measured by the proportionate contribution made by such segment to the total of the factors for that State."* (Emphasis added)

It may be granted appellant that so far as the Standard speaks to allocation bases for "typical pools" it is not addressing specific identification or direct allocation. However, the fact that the Standard addresses the treatment of pooled State and Local Income taxes and Franchise taxes does not negate the requirement for direct allocation when that can be done. Illustrative of this fact is the CAS Board's treatment of pension costs. CAS 403.40(a)(4) treats them as central payment on accruals and CAS 403.60 treats their allocation from a pool. Yet, as explained by the CAS Board's "Promulgation Comment" accompanying the promulgation of CAS 413 concerning pension costs:

"Normally, pension costs are 'Central payments or accruals' as that term is used in 4 CFR Part 403. Therefore, where pension costs can be computed for an individual segment, 4 CFR 403 would ordinarily require the amount so computed to be the amount allocated to such segment. The calculation of individual segment costs is, in effect, a direct allocation which is not only consistent with CAS 403, but is also consistent with the Board's cost allocation concepts as set forth in the Board Restatement of Objectives, Policies and Concepts. (May 1977)"

The import of our examination of the CAS Board's treatment of State and Local Income taxes and Franchise taxes is *not* that that treatment explicitly states that such taxes are to be directly allocated on an assessment base approach, but, rather that its treatment of these taxes demonstrates its rejection of the broad benefit test upon which appellant relies. In this case we have taken such an assessment base approach and looked to those factors upon which the various taxes in issue have been based. Where we have found that these factors permit a specific identification, we have concluded direct allocation is appropriate. Where we have found that these factors have not permitted specific identification, as in the case of the Renton tax, we have concluded an allocation on the basis of the various segments' contribution to those factors is appropriate. There being no income or franchise tax involved in this case, we have no evidence as to whether or not it would permit a direct allocation to individual segments.

For the foregoing reasons we conclude that the appellant's second argument is without merit.

The thrust of appellant's third argument is that this Board's decision does not produce "equitable" results, that there is not substantial evidence in the record to support a conclusion that the decision does produce "equitable" results, whereas on the contrary, there is substantial evidence that appellant's allocation method is equitable.

The appellant complains that whereas it is fundamental that "in adopting and interpreting principles or standards for allocation of costs for government contract costing and pricing purposes, . . . an equitable result must be achieved", our decision made "no finding of fact concerning and contains no mention of or reference to equity. . ." Appellant also points out that whereas government witnesses did not testify that its allocation would produce equitable results, the appellant's witness testified that its allocation method would produce equitable results.

The appellant argues that "if each type tax is directly assigned to a segment on an assessment base, there would be substantial variations from year to year as to the total amount of taxes ultimately allocated to each segment per employee assigned to each segment without any perceivable change in the respective benefits received by each segment." As "dramatically" demonstrable of this it refers to its exhibit 14.

Appellant's exhibit 14 is a comparison of the total tax cost allocated to segments according to the appellant's method and the government's method. It is set forth below:

**THE BOEING COMPANY    APPELLANT'S EXHIBIT 14**  
**COST OF WASHINGTON    Page 1 of 1**  
**STATE AND LOCAL TAXES**  
**1974**

**Comparison of Total Tax Costs Allocated to Segments by Boeing Method (Benefits Received)  
as Contrasted to Govt. Interpretation of CAS 403 (Assessment Base)**

	<u>Total Tax Costs/ Headcount</u>	<u>Boeing Aerospace Company</u>	<u>Boeing Commercial Airplane Company</u>	<u>Boeing Computer Services Inc.</u>	<u>Seattle Services Division</u>
<b>Tax Costs (\$ in Millions)</b>	<b>\$38.1</b>				
<b>Average Headcount</b>	<b>53,599</b>	<b>18,440</b>	<b>30,687</b>	<b>2,560</b>	<b>1,912</b>
<b>Cost Per Employee Boeing Method (Benefits)</b>	<b>\$710</b>	<b>\$710</b>	<b>\$710</b>	<b>\$710</b>	<b>\$710</b>
<b>Government Interpretation CAS 403 (Assessment Base)</b>	<b>\$710</b>	<b>\$466</b>	<b>\$865</b>	<b>\$820</b>	<b>\$440</b>



Using the same figures set forth on appellant's exhibit 14 the different result from using the different allocation methods may be seen to be as follows:

	<u>Total</u>	<u>Boeing</u>	<u>Boeing</u>	<u>Boeing</u>	<u>Seattle</u>
	<u>Tax Costs/</u>	<u>Aerospace</u>	<u>Commercial</u>	<u>Computer</u>	<u>Services</u>
	<u>Headcount</u>	<u>Company</u>	<u>Airplane</u>	<u>Services</u>	<u>Services</u>
		<u>Company</u>	<u>Company</u>	<u>Inc.</u>	<u>Division</u>
Tax Costs					
(\$ in					
Millions)	\$38.1				
Boeing					
Method					
(Benefits)		\$13,092,400	\$21,787,770	\$1,817,600	\$1,357,520
Government					
Inter-					
pretation					
CAS 402					
(Assess-					
ment Base)		8,593,040	26,544,255	2,099,200	841,280

The appellant notes that appellant's controller, Mr. Knutsen, testified, "and it should be pointed out again his testimony was unrefuted", that the allocation of the total tax cost of \$38.1 million on the basis of \$710 per person "represented an equitable allocation of such tax cost to each segment based on the benefits each segment derives from the community services provided by the respective taxing authorities. It is equitable because Boeing's business is labor intensive. (Tr. 326)" Noting that an allocation on the assessment base would achieve a different result per employee, appellant concludes rhetorically, "What clearer evidence could there be that assessment base method for allocating Boeing's taxes in the State of Washington would not allocate such taxes in accordance with the benefits received nor would it achieve an equitable result."

The appellant's argument is without merit. We have touched upon this argument earlier but will repeat it here. We have no doubt a goal of the rules concerning the allocation of costs is to reach an equitable result. As we noted earlier the ASPR definition of allocability (15-201.4) called for

allocation in accordance with an "equitable relationship". Furthermore, as appellant points out, the CAS Board itself initiated work on CAS 403 because of the "continuing problems between contractors and the Government concerning equitable allocations of home office expenses to segment" and because "assurance of equity in cost determinations and contract settlements is singularly lacking" under then-existing regulations.

We cannot agree with the appellant's implicit premise that the CAS Board has left open the question of whether or not appellant's or the Government's method of allocation produces equitable results. Rather, to eliminate the potential for continued dispute as to which method produces equitable results, it has filled the void that previously existing by prescribing methods which *it deems* produces equitable results. With respect to the allocation of taxes then it may be inferred that so far as the CAS Board ruled out allocation bases intended to measure the benefits a segment receives from community services funded with the taxes, it has concluded that such bases do not produce equitable results. So far as the CAS Board adopted an assessment base approach to the allocation of taxes, it may be inferred it concluded that use of such a base does produce equitable results. To this extent the CAS Board would appear to be in harmony with the conclusion reached by Professor Wright in his article cited at page 46 of our opinion as to the inadequacy of a pure benefit concept as a criterion for allocation of tax based on income. It appears then that appellant's quarrel is not with our decision but with the CAS Board.

Under the circumstances testimony of appellant's witnesses that this or that result is "equitable" is of little weight. While it is conceivable that a particular result might be so patently "inequitable" as to lead us to a conclusion that it could not have been intended, we find no such patent inequity here.

The appellant's comparison of the different per person consequences of the two contending allocation methods contains the faulty premise that what both purport to measure is the community services. Even were that premise

accepted, the proposition that the number of people in the segment is a measure of the community services is not supported by testimony of appellant's witness, Mr. Pilskey, that the benefits received are not subject to specific quantifiable measurement in most cases (App. Exh. 19), and is contradicted by the government's evidence that there is no correlation between headcount and the amount of taxes paid. (Govt. Exh. 12) It is clear, in any event, that the government's method does not purport to measure the benefit received from community services.

Plainly the government can argue with the same logic as the appellant that the assessment base measures the factors on which the tax cost is based; that that resulting allocation is equitable; that the headcount method produces an allocation to Boeing Aerospace Co. that in 1974, for example, was about 5 million dollars more than it *should* be and is therefore inequitable. Thus, it, may be seen that the dispute over what is an equitable basis for allocation could continue. The merit of such a government argument lies not in its logic but in its premise that the CAS Board has determined that allocation by an assessment base approach is consistent with the concepts of benefit and cause and is therefore equitable.

There is one other argument which bears mention. It was not explicitly raised in appellant's main brief although certain language there suggests it. It was presented in an article written by Michaels Katz entitled "An Analysis of Accounting Issues Involved in the Decision of ASBCA in the Boeing Company, ASBCA No. 19224". This unpublished article was submitted by the appellant before oral argument and was accepted by the Board as being in the nature of further argument. The Government was given opportunity to reply and did so. The same point was made by the appellant in a letter to the Board subsequent to oral argument, which pointed to certain more recently *proposed* Standards, CAS 417, 418, and 421, as demonstrating the correctness of its position.

The point made by the Katz article and which appellant finds in the newly-proposed standards is that *costs represent resources*. The proposition seems simple enough and

language to that effect may be found in cost accounting texts, the Standards, the CAS Board's Promulgating Comment and Policy statement. Indeed, both expert witnesses at the hearing gave testimony consistent with the proposition.

We deal with appellant's supplemental argument first. The CAS Board proposed five Standards dealing with the allocation of various indirect costs. They are titled as follows:

- 417 - Distinguishing between Direct and Indirect Cost
- 418 - Allocation of Service Center Costs
- 419 - Allocation of Material-related Overhead Costs
- 420 - Allocation of Manufacturing, Engineering and Comparable Overhead Costs
- 421 - Allocation of Indirect Costs

(Federal Register, Vol. 43, No. 52, 16 March 1978, pp. 11118 - 11127)

The appellant argues:

"The first of the proposed Standards, CAS 417, is significant for the distinctions it draws between costs which are to be directly assigned to final cost objectives, and costs which are to be pooled and allocated in accordance with the other Standards. CAS 403 similarly distinguishes between costs which are to be directly assigned to segments, and indirect costs which are to be allocated as provided elsewhere in that Standard.

"Under CAS 417, a direct cost is defined as one 'which is identified specifically with a particular final cost objective.' CAS 417.30(a)(3). Similarly, CAS 403 calls for direct assignment or allocation to segments of all central payments or accruals 'to the extent that all such payments or accruals . . . can be identified specifically with individual segments.' CAS 403.40(b)(4).

"In publishing CAS 403, the CAS Board did not define the key phrase 'identified specifically.' In CAS 417 it does. It sets out as a 'Fundamental requirement' the rules for determining whether a cost is to be treated as a direct cost (i.e., a specifically identifiable cost) or an indirect cost. A cost, under these rules, is direct if:

- 'the beneficial or causal relationship between the incurrence of the cost and the final cost objective is *clear and exclusive*,' (emphasis added) and
- 'the amount of the cost . . . is readily and economically measurable . . .,' and
- 'all other costs incurred for the same purpose in like circumstances can also be identified specifically with final cost objectives and accounted for as direct costs in compliance with [CAS 402].' CAS 417.40(a).

"The first of these three tests seems particularly relevant to CAS 403; that is, whether the beneficial or causal relationship between the incurrence of the cost and the final cost objective is 'clear and exclusive.' In CAS 417, the CAS Board explains the meaning of the 'clear and exclusive' test. That test is satisfied 'if the . . . [resource] with which that cost is identified is used on or applied to that final cost objective and that resource is separable from resources used on other cost objectives.' CAS 417.50(a)(1).

"To put it another way, if the resources (*e.g.*, in the Boeing case, the governmental services) purchased or made available through incurrence of a cost are not clearly used exclusively by one cost objective, then the cost should not be directly allocated solely to that cost objective.

"By promulgating CAS 417, with its explicit recognition that the beneficial-causal relationship is tied to the *resources* which the costs make available, the CAS Board has provided further guidance as to the correct interpretation of the words 'beneficial or causal' as used in CAS 403. In this Board's initial decision, the 'critical question' is described as 'how the CAS Board used the concepts of "benefit" and "cause"' (Opinion, p. 45). Now in CAS 417 we see that the beneficial or causal relationship between a cost and a cost objective arises out of the use or application of the '*resource* with which that cost is identified.' (Emphasis added.)



"The CAS Board's recognition of these two principles in CAS 417 cannot sensibly be confined to cost allocations to final cost objectives. The same principles must also govern the assignment of home office costs to segments under CAS 403.

"In the other Standards promulgated with CAS 417, the CAS Board again explicitly confirms that it is the consumption of the resource which the cost was used to purchase, that is the appropriate allocation base for indirect costs under the beneficial-causal tests.

"In CAS 418, 'Allocation of Service Center Costs,' the preferred allocation, which best meets the objective of allocating costs 'in reasonable proportion to the beneficial or causal relationship,' is by a 'resource consumption measure,' or if no measure of resource consumption or output is available, 'a surrogate that is representative of resources used.' CAS 418.40 ('Fundamental requirement'). The resources represented by all taxes paid by Boeing regardless of assessment base are governmental services. In paying such taxes, Boeing Headquarters in effect is a service center for such homogenous costs and services and it allocates such costs on a surrogate representation of the resources used. CAS 418.40 ('Fundamental requirement').

"Similarly in CAS 421, 'Allocation of Indirect Costs,' the CAS Board states that 'the preferred representation of the relationship between the indirect cost pool and the benefiting cost objectives is *a measure of resource consumption of the activity or activities represented by the indirect cost pool.*' (Emphasis added.) CAS 421.50(b). This will, according to the CAS Board, result in an allocation which is 'in reasonable proportion to the beneficial or causal relationship.' CAS 421.40(b) ('Fundamental requirement').

"Where the costs at issue are tax costs and the resources consumed are the governmental services which such taxes provide, the appropriate 'measure of resource consumption' is an allocation base that allocates the costs to the segments, and ultimately to the final cost objectives, which *use* such resources. The assessment base does not purport to measure resource consumption, and thus it

cannot be used as an allocation base to allocate costs in reasonable proportion to the beneficial or causal relationship required by CAS 403.

"While these proposed Standards do not directly address the allocation of home office expense to segments, it seems logical to assume that the words used by the CAS Board in CAS 403 and reused and explained in CAS 417, CAS 418 and CAS 421 have the same meaning and interpretation. Any question as to what the CAS Board meant by the phrase 'identified specifically' when used with the phrase 'beneficial or causal relationship' would now appear to have been clarified by the CAS Board itself. In each case, the answer depends on identification of the *resources* to which the costs are applied. If the resources acquired by the cost expenditure are not clearly and exclusively identifiable with a single cost objective or segment, that cost must be allocated to all benefited segments or cost objectives in reasonable proportion to the resources consumed by each such segment or cost objective."

We do not find these proposed standards demonstrably inconsistent with our interpretation of CAS 403. We hesitate to draw too freely from these proposed standards as a reflection of the CAS Board's conception because it has yet to receive the benefit of the full comment of all interested parties, so that the process of harmonizing all the standards is not complete. However, the definition of direct and indirect costs was published in CAS 400 even before the publication of CAS 403. On the basis of those definitions, it is clear that the problem of allocating home office expenses to segments is a problem in the allocation of an indirect cost. By definition direct costs are those allocated to "final cost objectives" and do not include costs allocated to "intermediate cost objectives" such as a segment. We appreciate that appellant does not contend the contrary. The appellant would, however, analogize the method of specifically identifying a cost to a final cost objective with the method of specifically identifying an indirect cost with a segment. We are not convinced the analogy is apt.

So far as CAS 417.40(a)(i) provides that in order for a cost to be treated as a direct cost of a final cost objective the

beneficial or causal relationship between the incurrence of the cost and the objective must be "clear and exclusive" we would agree that it is an aid in understanding the concept of "specific identifiability" as the word is used respecting the allocation of home office expenses to segments. Indeed, we would judge the relationship between the taxes paid (except the Renton tax) are clearly and exclusively identified with the appellant's segments with an assessment base approach.

However, the CAS Board's further amplification of the term "clear and exclusive" does not lead us to the conclusion appellant urges. The appellant argues that CAS 417.50(a)(i) indicates that if a "unit of labor, material, or other types of resources . . . is used on or applied to" a final cost objective and is separable from other resources used on other cost objective, it will be deemed to have a "clear and exclusive" beneficial or causal relationship to that final cost objective. It concludes from this that the relevant beneficial or causal relationship between a cost and a cost objective "arises out of the use or application of the 'resource with which that cost is identified' [emphasis added]." Further, it argues that since the resource which appellant obtains with the cost is governmental services which "are not clearly used exclusively by one cost objective" the cost of such resources should not be "directly allocated solely to that cost objective."

There is no doubt that a company incurs cost to acquire numerous resources, labor, material, etc. for various "process, products jobs, capitalized projects, etc." (cost objectives) and that to the extent these resources purchases are caused by the need for the resource to perform the work and are "used on or applied to" the work, there may exist a traceable clear and exclusive causal or beneficial relationship between the cost and the work, and the cost objective where the costs of the work are finally accumulated (final cost objective). It is equally clear that some of the resources thus acquired may not be so clearly and exclusively traced to the final cost objective. Such costs vis-a-vis a final cost objective must be treated as indirect costs.

We do not believe this is helpful to the appellant's cause however. The CAS Board might have taken appellant's view that tax costs are expended to acquire the resources (community services) they ultimately fund and sought to provide for the distribution of those costs to the segments which benefited from the consumption of those resources. However, it did not. Appellant notes, "The assessment base does not purport to measure resource consumption . . . ." Yet, since we remain convinced that the CAS Board selected an assessment base approach to the allocation of taxes, we conclude it did not conceive of the allocation of taxes as measuring the benefits of community services received.

Neither is the CAS Board treatment of indirect costs in CAS 421 inconsistent with our conclusion. That Standard explains it is applicable to "those items of indirect cost not covered by a specific Cost Accounting Standard. It does not require citation to support the proposition that in interpreting regulations the specific governs over the general in the event of an inconsistency. Even so, we are not prepared to conclude on this record that there is an inconsistency between the two standards. The CAS Board clearly was concerned with both beneficial and causal relationships between costs and cost objectives. If it treated the existence of the assessment base as the cause of the payment of the tax cost as the relevant relationship for allocating this cost from home office to segment, it is still operating within its concept of allocating according to the causal or beneficial relationship between a cost and a cost objective.

The respondent objected to the Board's considering appellant's submission of this argument after brief and oral argument were concluded and pointed out the fact that the standards from which appellant's argument proceeds are merely "proposed". We appreciate the respondent's point but are willing to consider the matter in hope it would contribute to an understanding of the CAS Board's overall design of which CAS 403 is a part.

The respondent also addressed the issue raised. Respondent understands the appellant's argument as follows:

"The thrust of the clarification is said by Appellant to be that the 'beneficial or causal' relationship between a cost and cost objective is tied to resource consumption. Appellant's position, as Respondent understands it, is (i) the resources represented by all taxes paid by Appellant, *regardless of the assessment base*, are governmental services and (ii) the assessment base does not purport to measure consumption, and thus cannot be used as an allocation base."

It notes that CAS 417 does not define the word "resource". Since the word is used in an accounting standard it urges consideration of "an accepted accounting definition". For this it points to a definition found in the American Institute of Certified Public Accountants' (AICPA) Accounting Principles Board (APB) Statement No. 4 dated October 1970 entitled "Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises" (CCH Accounting Principles, p. 9057) From this it concludes that "[T]he APB clearly considered that the imposition of taxes on an enterprise would not result in the enterprise's acquisition of resources." Thus, the use of the word "resources" in CAS 417 does not refer to governmental services received.

We are not persuaded that the use of the word "resources" in the context of financial accounting is necessarily identical to its use in cost accounting. APB Statement No. 4 indicates its focus is financial accounting which is primarily concerned with the measurement of economic resources, economic obligations and changes in them. It defines "economic resources" to include:

Productive resources composed of material, plant, intangibles, and services used in production; and contractual rights to productive resources.

Products: completed and partially completed.

Money: Claims to receive money; and ownership of other enterprises.



It defines "economic obligations" as including the responsibility to transfer economic resources and provide services. As a part of this definition it explains,

"Obligations usually arise because the enterprise has received resources from other entities through purchase or borrowing. Some obligations arise by other means, for example, through the imposition of taxes or through legal action."

It is this language which is the basis for respondent's conclusion. The Statement also defines "Residual Interest". These three categories describe the assets, liabilities, and net worth commonly seen on enterprise balance sheets.

In discussing the measure of changes in economic resources, economic obligations and residual interests, the Statement categorizes those related to "External events" such as transfers of resources or obligations to and from other entities. These it subcategorizes as reciprocal transfers, i.e. exchanges, and non-reciprocal transfers to or from the enterprise. Such non-reciprocal transfers may be between the enterprise and its owners or between the enterprise and entities other than owners. In the latter category it includes taxes. The implication is that the Statement treats taxes as a transfer out of a resource, money, for which there is no reciprocal inflow of a resource.

Notwithstanding, this treatment of taxes for purposes of financial accounting we hesitate to place reliance on it. It seems to us that the rationale underlying the presentation of financial accounting information, i.e. a conservative representation of an enterprise assets, liabilities and net worth, is sufficient to explain why such benefits as might be available from governmental services would not be reflected among the enterprise's depiction of its "economic resources." This, of course, is not to say that such benefits were treated as resources by the CAS Board.

Mr. Katz's article rests on the same premise as appellant's that costs represent resources which are obtained by expenditure of the costs, that the resource appellant obtains for the payment of taxes is governmental services and that

the goal of allocation is to distribute these costs to those who benefit from those governmental services. He recognizes that "Some would argue that the cause of a property tax is ownership of the property being taxed or that the benefit is obtained from the fact that the government does not seize the property for nonpayment of taxes."\* He refutes this by saying, "But, as our discussion has shown, these 'causes' and 'benefits' are not relevant to the cost allocation problem at issue since they do not address the fundamental purpose of the tax costs, i.e., the resources represented by the cost and the relationship of those resources to Boeing's segments (cost objectives) . . . the issue for cost allocation is not how the cost was incurred or who paid it but what resources (services, material, assets, etc) were obtained and which cost objective utilized or potentially utilized these resources, i.e. which cost objectives benefited from the resources."

The author proceeds from the premise that that which is properly measured is the benefits segments received from government services to the conclusion that they may not be specifically identified to a particular segment thus must be pooled and allocated on some basis. He examines four tiers of preferable allocation techniques. One is to use a base that measures the resources flowing to the cost objective. Such a base, he concludes, cannot be used objectively to measure the governmental resources provided to Boeing. A second is to use a base that measures the output of the resources, the goods or services produced. This base assumes that the average amount of resource is used per unit of output. Thus, if a segment is charged that part of the total cost of the resources used to product [sic] the unit's output which is measured by the number of units it receives "equity is achieved." This measure is also unavailable for taxes.

The author's third tier method comes into play when neither a resource usage measure nor an output of resources measure is available. Then, it is necessary to use a surrogate

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\* This is apparently an allusion to the testimony of the Government's expert witness, Professor Gordon Schillinglaw, who testified to that effect.

for resource usage. "Such a surrogate is generally a measure of the activity of the cost objective; the assumption being that the greater the cost objective's activity, the greater is its consumption of the resources represented by the cost."

His fourth tier method concerns pooled costs which cannot readily be allocated on measures of specific beneficial or causal relationships. These generally represent the cost of overall management activity and should be allocated over a base representative of the entire activity being managed.

These so-called tiers the author paraphrases from the CAS Board Restatement of Policies published in the Federal Register. (Dec 77-14291 filed 18 May 1977)\*

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\* *"Hierarchy For Allocating Cost Pools*

"Costs not directly identified with final cost objectives should be grouped into logical and homogeneous expense pools and should be allocated in accordance with a hierarchy of preferable techniques. The costs of like functions have a direct and definitive relationship to the cost objectives for which the functions are performed and the grouping of such costs in homogeneous pools for allocation to benefiting cost objectives results in better identification of cost with cost objectives.

"The Board believes there is a hierarchy of preferable allocation techniques for distributing homogeneous pools of cost. The preferred representation of the relationship between the pooled cost and the benefiting cost objectives is a measure of the activity of the function represented by the pool of cost. Measures of the activities of such functions ordinarily can be expressed in such terms as labor hours, machine hours, or square footage. Accordingly, costs of these functions can be allocated by use of a rate, such as a rate per labor hour, rate per machine hour or cost per square foot, unless such measures are unavailable or impractical to ascertain. In these latter cases, the basis for allocation can be a measurement of the output of the supporting function. Output is measured in terms of units of end product produced by the supporting functions, as for example, number of printed pages for a print shop, number of purchase orders processed by a purchasing department, number of hires by an employment office.

"Where neither activity nor output of the supporting function can be measured practically, a surrogate for the beneficial or causal relationship should be selected. Surrogates used to represent the

(continued on next page)

The first three "tiers" the author notes are described in CAS 403.50(b) "Techniques for application". The fourth "tier" appears to refer to 403.50(c) concerning the allocation of "Residual expenses".

Mr. Katz notes a distinction between the third and fourth tier of allocation. The third "is oriented toward resources which provide specific types of services or manage specific types of functions where one or a limited number of aspects of the cost objective's activities would be the most relevant surrogate for, and would vary most proportionately with, the benefits provided by the resources." The fourth "is oriented towards resources which provide overall management direction or support where a broader measure of the overall activity of the cost objectives may be a more appropriate surrogate."

He notes some difficulty fitting appellant's situation into either the third or fourth tier since the relationship between the taxes and the segments "has aspects which lend themselves to either a third or a fourth tier allocation. The costs themselves represent specific governmental (state and local) services and are not managerial in nature. Thus, the third tier terminology is most appropriate. On the other hand, no specific type of business function or activity can be clearly singled out as most representative of the beneficial

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- \* relationship are generally measures of activity of the cost objectives receiving the service. Any surrogate used should be a reasonable measure of the services received and should vary in proportion to the services received.

"Pooled costs which cannot readily be allocated on measures of specific beneficial or causal relationship generally represent the cost of overall management activities. These costs should be grouped in relation to the activities managed and the base selected to measure the allocation of these indirect costs to cost objectives should be a base representative of the entire activity being managed. For example, the total cost of plant activities managed might be a reasonable base for allocation of general plant indirect costs. The use of a portion of a total activity, such as direct labor costs or direct material costs only, as a substitute for a total activity base, is acceptable only if the base is a good representative of the total activity being managed."

relationship or most directly variable with the services received. Thus, the base selected should be representative of Boeing's entire business activity, as the terminology describing a fourth tier allocation would suggest." This does not discourage him, however, for he concludes "In any event, viewed either as a third tier situation or a fourth tier situation, or a combination of both, the conclusion is the same; the allocation base used should be a measure of the overall business activity of Boeing's Seattle-area segments". That base he concludes is headcount because Boeing's business activity is labor intensive.

Mr. Katz further discusses another base for the allocation of pooled costs. That is an allocation base representative of the factors on which the total payment is based. This, of course, is the type of base called out by CAS 403.40(b)(4) for central payments or accruals. He seems to treat this as an example of his third tier allocation methods. He notes "The 'factors' upon which payment is based may frequently be the computational factors, but only when such computations are consistent with the underlying beneficial or causal factors which actually generated the payment." He notes that CAS 403 illustrates "state and local income taxes and franchise taxes are allocated among segments in a taxing jurisdiction using the factors by which the tax was determined for that jurisdiction." This he understands is "one cost . . . being allocated to several segments using a surrogate for the beneficial or causal relationship". He points out that sometimes the computational factors will provide a proper allocation and sometimes they will not. He says:

"To the extent that factors used to assess income taxes are generally broad measures of the business activity of a company, e.g., combinations of payroll, revenue, and property factors, it is to be expected that in many cases these computational factors will provide a good allocation base in accordance with the underlying beneficial or causal factors and consistent with the third tier of the preference hierarchy.

"Where the circumstances are such that we must allocate the tax cost to the one and only one segment which does business in a particular taxing



jurisdiction and does business in no other jurisdiction, the assessment factors for that taxing jurisdiction are appropriately used to determine the amount of tax cost paid to the taxing jurisdiction and, thus, the amount of tax cost to specifically identify to the one segment (since it is the only segment receiving services from the taxing jurisdiction).

"However, where several segments are active in a taxing jurisdiction and where the assessment factors do not provide a homogeneous measure of business activity in all of those segments, the assessment factors will not provide an allocation base consistent with the underlying beneficial relationships or factors truly causing the tax payments. Perhaps the clearest example is provided by a property tax levied upon a business with two comparable segments in the same taxing jurisdiction except that segment A uses only property furnished by its customers, on which no tax is paid by the company, while segment B uses property owned by the company and upon which the entire property tax is paid. . . . The benefits of the tax cost go to both segments while the measurable property resides in only one segment and thus an allocation base consisting of assessed value of owned property is not homogeneous and does not result in an equitable allocation in accordance with the beneficial or causal relationship. A situation comparable to this does exist in Boeing's circumstances where the State of Washington levies a business inventory property tax that applies only to the commercial inventory controlled by Boeing's commercial airplane segment."

The foregoing analysis raises certain questions. Mr. Katz seems to acknowledge that the three computational factors, a combination of payroll, revenue and property, are a broad measure of the business activity of the company and can provide a good allocation base for the allocation to segments of the benefits received from community services. He alludes to this as consistent with his third tier on the preferential hierarchy. However, following his logic, it seems rather more like his fourth tier which is the method used by the CAS Board to allocate "residual expenses." It is a method which the CAS Board deemed "representative of the total activity" of segments. (CAS 403.50(c)(2)) The only reason he gives for

not treating this as a fourth tier allocation of Residual Expenses is that the costs do not represent managerial services. One must ask, if the allocation base is the same for both, i.e. a broad measure of the business activity of the company, why would not the CAS Board have treated them as Residual Expenses? A reason that suggests itself is that Mr. Katz's conclusion that the allocation of taxes is to measure the benefits received from Government services is contrary to the CAS Board's conception.

Still following his logic one may understand his conclusion that if there is only one segment in a taxing jurisdiction it receives all the benefits from community service which represent the tax cost and so may be equitably allocated (directly) all the tax cost. Yet, why when there is more than one segment in the taxing jurisdiction, would not the three factor base provide a good measure of the business activity of the company's business and so a good measure for allocating income tax? It seems to us that if the CAS Board's objective in allocating income tax to segments was to measure the community services funded with the tax, Mr. Katz logic would suggest they be treated more like "residual expenses". The fact that the computational base used by the states imposing an income tax may change from state to state would not alter the fact that the total tax pays for the total benefits and a distribution according to a three factor formula would provide an allocation that is a good measure of the company's business activity. The different computational bases that might be used by the state could, however, result in different allocations than would be obtained by using a three factor formula. Since the CAS Board selected as a base for the allocation of taxes the state's assessment base, it suggests the Board was not looking at the benefit from community services nor did it conceive of the community services as "truly causing" the tax payment.

We note also Mr. Katz "clearest example" of an assessment base approach not providing an allocation of taxes according to the benefits received from community services, that is not "consistent with the underlying beneficial relationship or factors truly causing the tax

payment." He points out that the allocation of a tax on commercial inventory to two segments, one of which uses that inventory and one of which uses only customer (Government)-furnished inventory, would be entirely to the segment using the commercial inventory. This, of course, is precisely the problem which faced the Court of Claims in *Lockheed Aircraft Corp. v. United States*, 179 Ct. Cl. 545 (1967) wherein the court announced the broad benefit test. It is the precise problem which was addressed by ASPR 15-205.41(a)(v) which was understood by the Court of Claims in *The Boeing Company v. United States*, 202 Ct. Cl. 315 (1973) to preclude treating such tax cost as part of a government contract.\*

While we would agree with Mr. Katz that the allocation of the commercial inventory tax only to the segment using that inventory would not distribute to the other segment in accordance with the *Lockheed* broad benefit test, we do not believe that helpful to the appellant. So far as the allocation of the income tax to two segments on an assessment base likewise would "not provide an allocation base consistent with the underlying beneficial relationships [Government services received] or factors truly causing the tax payment" [the community need for service], it is clear that the CAS Board adoption of the assessment base approach is a rejection of the broad benefit approach. Thus, again we must note that appellant's argument is suited more to demonstrating that the CAS Board ought not to have

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\* One might have concluded that ASPR 15-205.41(a)(v) although found in the part of ASPR concerned with the particular treatment of particular costs, described a method of allocating the commercial inventory tax according to its assessment base in a manner inconsistent with the broad benefit test announced in *Lockheed*. Indeed, the appellant in *The Boeing Company* urged that proposition. (*The Boeing Co.*, at 328) Although the court seems to have recognized it as prescribing a "requirement of direct costing" (at 330), the Court did not treat it as a rejection of the broad benefit test announced in *Lockheed*, noting only that it "plainly prohibits the allowance of personal property taxes on commercial inventory as a cost of performing a Government contract." (at 330)

selected the assessment base approach than to showing that it did not.\*

In conclusion, we find no merit in any of the arguments presented and remain convinced that CAS 403 precludes an allocation of the State and Local taxes to segments on a headcount base and that an allocation of the taxes on an assessment base basis complies with the Standard. Our decision is affirmed.

Dated 31 January 1979.

/s/Talbot J. Nicholas

TALBOT J. NICHOLAS,  
Colonel, JAGC  
Administrative Judge  
Member of Division No. 2,  
Armed Services Board of  
Contract Appeals

I concur

/s/John J Norman

JOHN J. NORMAN  
Administrative Judge  
Member pro tem of Division  
No. 2, Armed Services  
Board of Contract Appeals

RUTH C. BURG  
Administrative Judge  
Member of Division No. 2,  
Armed Services Board of  
Contract Appeals, did not  
participate in the determina-  
tion of this decision.

THOMAS E. BURNS  
Administrative Judge  
Member of Division No. 2,  
Armed Services Board of  
Contract Appeals, did not  
participate in the determina-  
tion of this decision.

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\* Though we have addressed the subject of commercial inventory, personal property tax because raised by Mr. Katz, that tax has not been a part of this litigation. The parties stipulated at the outset of the hearing that it would not be allowed and that there was no dispute about it. (Tr.4)

I concur

/s/Richard C. Solibakke  
RICHARD C. SOLIBAKKE  
Administrative Judge  
Chairman, Armed Services  
Board of Contract Appeals

I concur

/s/Harris J. Andrews Jr.  
HARRIS J. ANDREWS, JR.,  
Administrative Judge  
Vice Chairman, Armed Services  
Board of Contract Appeals

I certify that the foregoing is a true copy of the opinion and decision of the Armed Services Board of Contract Appeals in ASBCA No. 19224, Appeal of the Boeing Company, on Motion for Reconsideration, rendered in conformance with the Board's Charter.

Dated: 26 FEB 1979

/s/George L. Hawkes  
GEORGE L. HAWKES,  
Recorder  
Armed Services Board of  
Contract Appeals



## ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeal of — )

The Boeing Company )

ASBCA No. 19224 )

Under Contract No. F33-657-73-C-0257 )

ADMINISTRATIVE CORRECTION OF OPINION ON  
MOTION FOR RECONSIDERATION

The decision on reconsideration dated 31 January 1979 at page 33 is corrected by deleting the footnote.

The following is added to page 1:

(1) Add an asterisk after the citation to the Board's prior decision.

(2) Add the following footnote:

\*The first full paragraph reported at page 59,896 omits certain language of the decision. The paragraph should read as follows:

"Although the CAS Board modified the definition of direct cost to include only those specifically identifiable with a 'final' (rather than particular) cost objective, e.g. a contract, and thus placed the Government's argument under the CAS 403 language calling for 'direct allocation' of an 'indirect cost,' the ASPR language in 15-201.4, quoted above, was not changed. Why, then, one must ask, should not that language permit measuring benefits received from community services on a head count basis? Our answer is that CAS 403 concept of allocation according to beneficial or causal relationships, as evidenced by its treatment of the allocation of income taxes, contemplates that a benefitted segment's share of the tax payment will be measured by such as base as will measure the proportionate contribution to the factors that constitute the assessment base of the tax. Rather than measuring the benefits received from community services by the Corporation, its segments, and its employees, it measures the contribution to those factors that give rise to or cause the assessment of the tax, and the benefit which may be conceived of as accruing to the segment by the home office payment of the tax."

C-47

The underscored language was omitted.

Dated 19 March 1979.

/s/Talbot J. Nicholas

TALBOT J. NICHOLAS,  
Colonel, JAGC  
Administrative Judge  
Member of Division No. 2,  
Armed Services Board of  
Contract Appeals

**APPENDIX D**

**ORIGINAL**

**IN THE UNITED STATES COURT OF CLAIMS**

**August 20, 1982**

**ORDER**

**PER CURIAM: IT IS ORDERED** that the motions of the parties as set forth, for rehearing, reconsideration or other relief under Rules 7(d), 151 and 152 are **DENIED**:

**App. 8-81 Felipe Lagnas**

Petitioner's motion for reconsideration filed July 8, 1982 of order dated November 10, 1981. (NICHOLS, KASHIWA and SMITH, *Judges*)

**236-C Gila River Pima-Maricopa Indian Community, et al.**

Plaintiffs' motion for rehearing *en banc* filed July 19, 1982 of opinion and order dated June 30, 1982. (FRIEDMAN, *Chief Judge*, DAVIS, NICHOLS, BENNETT and SMITH, *Judges*)

**268-79C The Boeing Company**

Plaintiff's motion for rehearing and suggestion for rehearing *en banc* filed July 21, 1982 of opinion dated June 2, 1982. (FRIEDMAN, *Chief Judge*, DAVIS, NICHOLS, KASHIWA, BENNETT and SMITH, *Judges*)

**666-80C Robert J. Ables**

Plaintiff's motion for relief from order filed July 12, 1982 of an order dated March 26, 1982. (FRIEDMAN, *Chief Judge*, DAVIS and NICHOLS, *Judges*)

**APPENDIX E**

**Supreme Court of the United States**

**No. A-410**

**BOEING COMPANY,**

**Petitioner,**

**v.**

**UNITED STATES**

---

**ORDER EXTENDING TIME TO FILE PETITION FOR  
WRIT OF CERTIORARI**

---

**UPON CONSIDERATION** of the application of counsel  
for petitioner,

**IT IS ORDERED** that the time for filing a petition for  
writ of certiorari in the above-entitled cause be, and the same  
is hereby, extended to and including December 18, 1982

/s/ Warren E. Burger

*Chief Justice of the  
United States.*

**Dated this 3rd  
day of November, 1982**

**APPENDIX F**  
**U.S. Const. Art. II**  
**THE PRESIDENT**

No Person except a natural born Citizen, or a Citizen of the United States, at the time of the Adoption of this Constitution, shall be eligible to the Office of President; neither shall any Person be eligible to that Office who shall not have attained to the Age of thirty five Years, and been fourteen Years a Resident within the United States.

In Case of the Removal of the President from Office, or of his Death, Resignation, or Inability to discharge the Powers and Duties of the said Office, the same shall devolve on the Vice President, and the Congress may by Law provide for the Case of Removal, Death, Resignation or Inability, both of the President and Vice President, declaring what Officer shall then act as President, and such Officer shall act accordingly, until the Disability be removed, or a President shall be elected.

The President shall, at stated Times, receive for his Services, a Compensation, which shall neither be encreased nor diminished during the Period for which he shall have been elected, and he shall not receive within that Period any other Emolument from the United States, or any of them.

Before he enter on the Execution of his Office, he shall take the following Oath or Affirmation:—"I do solemnly swear (or affirm) that I will faithfully execute the Office of President of the United States, and will to the best of my Ability, preserve, protect and defend the Constitution of the United States."

Section 2. The President shall be Commander in Chief of the Army and Navy of the United States, and of the Militia of the several States, when called into the actual Service of the United States; he may require the Opinion, in writing, of the principal Officer in each of the executive Departments, upon any Subject relating to the Duties of their respective Offices, and he shall have Power to grant Reprieves and Pardons for Offenses against the United States, except in Cases of Impeachment.



He shall have Power, by and with the Advice and Consent of the Senate, to make Treaties, provided two thirds of the Senators present concur; and he shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consuls, Judges of the supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.

The President shall have Power to fill up all Vacancies that may happen during the Recess of the Senate, by granting Commissions which shall expire at the End of their next Session.

#### 50 U.S.C. App. § 2168

**§ 2168. Cost Accounting Standards Board—Formation; Comptroller General as chairman; experience of Board members; terms of office; vacancies; compensation of Board members appointed from private life**

(a) There is established, as an agent of the Congress, a Cost-Accounting Standards Board which shall be independent of the executive departments and shall consist of the Comptroller General of the United States who shall serve as Chairman of the Board and four members to be appointed by the Comptroller General. Of the members appointed to the Board, two, of whom one shall be particularly knowledgeable about the cost accounting problems of small business, shall be from the accounting profession, one shall be representative of industry, and one shall be from a department or agency of the Federal Government who shall be appointed with the consent of the head of the department or agency concerned. The term of office of each of the appointed members of the Board shall be four years, except that any member appointed to fill a vacancy in the Board shall serve for the remainder of the term for which his predecessor was appointed. Each member of the Board appointed from private life shall receive compensation at the rate of one two-hundred-sixtieth of the rate-prescribed for

level IV of the Federal Executive Salary Schedule [section 5315 of Title 5] for each day (including traveltime) in which he is engaged in the actual performance of duties vested in the Board.

**Appointment and compensation of staff members**

(b) The Board shall have the power to appoint, fix the compensation of, and remove an executive secretary and two additional staff members without regard to chapter 51, subchapters III and VI of chapter 53, and chapter 75 of title 5, United States Code, and those provisions of such title relating to appointment in the competitive service. The executive secretary and the two additional staff members may be paid compensation at rates not to exceed the rates prescribed for levels IV and V of the Federal Executive Salary Schedule, respectively [sections 5315 and 5316 of Title 5].

**Appointment and compensation of other necessary personnel**

(c) The Board is authorized to appoint and fix the compensation of such other personnel as the Board deems necessary to carry out its functions.

**Utilization of personnel from Federal agencies or private life**

(d) The Board may utilize personnel from the Federal Government (with the consent of the head of the agency concerned) or appoint personnel from private life without regard to chapter 51, subchapters III and VI of chapter 53, and chapter 75 of title 5, United States Code, and those provisions of such title relating to appointment in the competitive service, to serve on advisory committees and task forces to assist the Board in carrying out its functions and responsibilities under this section.

**Compensation of Board members and other personnel from Federal agencies; compensation of appointees from private life; travel expenses for personnel serving on an intermittent basis**

(e) Except as otherwise provided in subsection (a), members of the Board and officers or employees of other agencies of the Federal Government utilized under this section shall receive no compensation for their services as such but shall continue to receive the compensation of their regular positions. Appointees under subsection (d) from private life shall receive compensation at rates fixed by the Board, not to exceed one two-hundred sixtieth of the rate prescribed for level V in the Federal Executive Salary Schedule [section 5316 of Title 5] for each day (including traveltime) in which they are engaged in the actual performance of their duties as prescribed by the Board. While serving away from their homes or regular place of business, Board members and other appointees serving on an intermittent basis under this section shall be allowed travel expenses in accordance with section 5703 of title 5, United States Code.

**Cooperation between Board and other Federal departments and agencies**

(f) All departments and agencies of the Government are authorized to cooperate with the Board and to furnish information, appropriate personnel with or without reimbursement, and such financial and other assistance as may be agreed to between the Board and the department or agency concerned.

**Promulgation of cost accounting standards; use of standards by defense contractors and relevant Federal agencies; conditions for use of standards; inflationary effect of standards and implementing major rules and regulations; report to Congress; contents**

(g) The Board shall from time to time promulgate cost-accounting standards designed to achieve uniformity and consistency in the cost-accounting principles followed by defense contractors and subcontractors under Federal contracts. Such promulgated standards shall be used by all

relevant Federal agencies and by defense contractors and subcontractors in estimating, accumulating, and reporting costs in connection with the pricing, administration and settlement of all negotiated prime contract and subcontract national defense procurements with the United States in excess of \$100,000, other than contracts or subcontracts where the price negotiated is based on (1) established catalog or market prices of commercial items sold in substantial quantities to the general public, or (2) prices set by law or regulation. In promulgating such standards and major rules and regulations for the implementation of such standards, the Board shall take into account, and shall report to the Congress in the transmittal required by section 719(h)(3) of this Act [subsec. (h)(3) of this section] the probable costs of implementation, including inflationary effects, if any, compared to the probable benefits, including advantages and improvements in the pricing, administration, and settlement of contracts.

**Implementation of cost accounting standards; cost accounting disclosure by defense contractors as a condition of contract; mandatory price adjustment clause in contract, with interest, for any increased costs due to contractor's failure to follow cost accounting standards; maximum rate and duration of interest; contract dispute; exemptions; effective date of proposed standards and regulations**

(h) (1) The Board is authorized to make, promulgate, amend, and rescind rules and regulations for the implementation of cost-accounting standards promulgated under subsection (g). Such regulations shall require defense contractors and subcontractors as a condition of contracting to disclose in writing their cost-accounting principles, including methods of distinguishing direct costs from indirect costs and the basis used for allocating indirect costs, and to agree to a contract price adjustment, with interest, for any increased costs paid to the defense contractor by the United States because of the defense contractor's failure to comply with duly promulgated cost-accounting standards or to follow consistently his disclosed cost-accounting practices in pricing contract proposals and in accumulating and reporting contract performance cost data. Such interest

shall not exceed 7 per centum per annum measured from the time such payments were made to the contractor or subcontractor to the time such price adjustment is effected. If the parties fail to agree as to whether the defense contractor or subcontractor has complied with cost-accounting standards, the rules and regulations relating thereto, and cost adjustments demanded by the United States, such disagreement will constitute a dispute under the contract dispute clause.

(2) The Board is authorized, as soon as practicable after the date of enactment of this section [Aug. 15, 1970], to prescribe rules and regulations exempting from the requirements of this section such classes or categories of defense contractors or subcontractors under contracts negotiated in connection with national defense procurements as it determines, on the basis of the size of the contracts involved or otherwise, are appropriate and consistent with the purposes sought to be achieved by this section.

(3) Cost-accounting standards promulgated under subsection (g) and rules and regulations prescribed under this subsection shall take effect not earlier than the expiration of the first period of sixty calendar days of continuous session of the Congress following the date on which a copy of the proposed standards, rules, or regulations is transmitted to the Congress; if, between the date of transmittal and the expiration of such sixty-day period, there is not passed by the two Houses a concurrent resolution stating in substance that the Congress does not favor the proposed standards, rules, or regulations. For the purposes of this subparagraph, in the computation of the sixty-day period there shall be excluded the days on which either House is not in session because of adjournment of more than three days to a day certain or an adjournment of the Congress sine die. The provisions of this paragraph do not apply to modifications of cost accounting standards, rules, or regulations which have become effective in conformity with those provisions.



**Publication in Federal Register of cost accounting standards and regulations; submission and consideration of views and comments by interested parties; standards, regulations and modifications thereof as having full force and effect of law; effective date; exclusion of functions exercised from operation of specified laws; exemptions**

(i) (A) Prior to the promulgation under this section of rules, regulations, cost-accounting standards, and modifications thereof, notice of the action proposed to be taken, including a description of the terms and substance thereof, shall be published in the Federal Register. All parties affected thereby shall be afforded a period of not less than thirty days after such publication in which to submit their views and comments with respect to the action proposed to be taken. After full consideration of the views and comments so submitted the Board may promulgate rules, regulations, cost-accounting standards, and modifications thereof which shall have the full force and effect of law and shall become effective not later than the start of the second fiscal quarter beginning after the expiration of not less than thirty days after publication in the Federal Register.

(B) The functions exercised under this section are excluded from the operation of sections 551, 553-559, and 701-706 of title 5, United States Code.

(C) The provisions of paragraph (A) of this subsection shall not be applicable to rules and regulations prescribed by the Board pursuant to subsection (h) (2).

**Determination of compliance with cost accounting standards; right of authorized person to examine and copy relevant records of contractor**

(j) For the purpose of determining whether a defense contractor or subcontractor has complied with duly promulgated cost-accounting standards and has followed consistently his disclosed cost-accounting practices, any authorized representative of the head of the agency concerned, of the Board, or of the Comptroller General of the United States shall have the right to examine and make copies of any documents, papers, or records of such

contractor or subcontractor relating to compliance with such cost-accounting standards and principles.

### **Reports to Congress by Board**

(k) The Board shall report to the Congress, not later than twenty-four months after the date of enactment of this section [Aug. 15, 1970], concerning its progress in promulgating cost-accounting standards under subsection (g) and rules and regulations under subsection (h). Thereafter, the Board shall make an annual report to the Congress with respect to its activities and operations, together with such recommendations as it deems appropriate.

### **Authorization of appropriations**

(l) There are authorized to be appropriated such sums as may be necessary to carry out the provisions of this section. Sept. 8, 1950, c. 932, Title VII, § 719, as added Aug. 15, 1970, Pub.L. 91-379, Title I, § 103, 84 Stat. 796; Dec. 16, 1975, Pub.L. 94-152, § 7, 89 Stat. 820.

**Codification.** Amendment by Pub.L. 94-152 has not been executed to section 717(g) of the Defense Production Act of 1950 as provided for in the enacting language of section 6 of Pub.L. 94-152 but to section 719 of the Defense Production Act of 1950 (this section) as the probable intent of Congress.

**1975 Amendment.** Subsec. (g). Pub.L. 94-152 added provisions relating to applicability to promulgation of major rules and regulations for implementing standards, and requirement that the Board consider and report to Congress the probable inflationary effects, if any, and advantages or improvements in pricing, administration and settlement of contracts in promulgating standards, rules and regulations.

**Effective Date of 1975 Amendment.** Amendment by Pub.L. 94-152 effective at the close of Nov. 30, 1975, see section 9 of Pub.L. 94-152, as amended, set out as a note under section 2158 of this Appendix.

**Legislative History.** For legislative history and purpose of Pub.L. 91-379, see 1970 U.S. Code Cong. and Adm. News,

p. 3768. See also, Pub.L. 94-152, 1976 U.S. Code Cong. and Adm. News, p. 1588.

**COST ACCOUNTING STANDARD 403**  
**PART 403—ALLOCATION OF HOME OFFICE**  
**EXPENSES TO SEGMENTS**

**Sec.**

- 403.10 General applicability.
- 403.20 Purpose.
- 403.30 Definitions.
- 403.40 Fundamental requirement.
- 403.50 Techniques for application.
- 403.60 Illustrations.
- 403.70 Exemptions.
- 403.80 Effective date.

**Preambles A—E**

**AUTHORITY:** Sec. 103, 84 Stat. 796; 50 U.S.C. App. 2168.

**SOURCE:** 37 FR 22683, Dec. 14, 1972, unless otherwise noted.

**NOTE:** A supplement, consisting of the preambles to these regulations as they appeared in the **FEDERAL REGISTER**, follows the text of this part. These preambles, which are intended to explain the regulations in non-technical language, are printed in chronological order to provide an administrative history of the cost accounting standards.

The preamble to the original publication of this part (37 FR 22683, December 14, 1972) is set forth in preamble A of the supplement.

For preambles to amendments and revisions which affect only certain sections, see the references following those sections.

OFR is interested in receiving comments from readers on this new format. Comments should be sent to : Office of the Federal Register, National Archives and Records Service, General Services Administration, Washington, D.C. 20408.

**§ 403.10 General applicability.**

General applicability of this cost accounting standard is established by § 331.30 of the Board's regulations on applicability, exemption, and waiver of the requirement to include the cost accounting standards contract clause in negotiated defense prime contracts and subcontracts (§ 331.30 of this chapter).

[43 FR 24820, June 8, 1978]

**PREAMBLES:** For preamble to § 403.10, see preamble E of the supplement to this part. For preamble to superseded regulations, see preamble A of the supplement.

**§ 403.20 Purpose.**

(a) The purpose of this Cost Accounting Standard is to establish criteria for allocation of the expenses of a home office to the segments of the organization based on the beneficial or causal relationship between such expenses and the receiving segments. It provides for: (1) Identification of expenses for direct allocation to segments to the maximum extent practical; (2) accumulation of significant nondirectly allocated expenses into logical and relatively homogeneous pools to be allocated on bases reflecting the relationship of the expenses to the segments concerned; and (3) allocation of any remaining or residual home office expenses to all segments. Appropriate implementation of this Standard will limit the amount of home office expenses classified as residual to the expenses of managing the organization as a whole.

(b) This Standard does not cover the reallocation of a segment's share of home office expenses to contracts and other cost objectives.

**§ 403.30 Definitions.**

(a) The following definitions of terms which are prominent in this Standard are reprinted from Part 400 of this chapter for convenience. Other terms which are used in this Standard and are defined in Part 400 of this chapter have the meanings ascribed to them in that part unless the text demands a

different definition or the definition is modified in paragraph (b) of this section:

(1) *Allocate*. To assign an item of cost, or a group of items of cost, to one or more cost objectives. This term includes both direct assignment of cost and the reassignment of a share from an indirect cost pool.

(2) *Home office*. An office responsible for directing or managing two or more, but not necessarily all, segments of an organization. It typically establishes policy for, and provides guidance to the segments in their operations. It usually performs management, supervisory, or administrative functions, and may also perform service functions in support of the operations of the various segments. An organization which has intermediate levels, such as groups, may have several home offices which report to a common home office. An intermediate organization may be both a segment and a home office.

(3) *Operating revenue*. Amounts accrued or charged to customers, clients, and tenants, for the sale of products manufactured or purchased for resale, for services, and for rentals of property held primarily for leasing to others. It includes both reimbursable costs and fees under cost-type contracts and percentage-of-completion sales accruals except that it includes only the fee for management contracts under which the contractor acts essentially as an agent of the Government in the erection or operation of Government-owned facilities. It excludes incidental interest, dividends, royalty, and rental income, and proceeds from the sale of assets used in the business.

(4) *Segment*. One of two or more divisions, product departments, plants, or other subdivisions of an organization reporting directly to a home office, usually identified with responsibility for profit and/or producing a product or service. The term includes Government-owned contractor-operated (GOCO) facilities, and joint ventures and subsidiaries (domestic and foreign) in which the organization has a majority ownership. The term also includes those joint ventures and subsidiaries (domestic and foreign) in which the



organization has less than a majority of ownership, but over which it exercises control.

(5) *Tangible capital asset.* An asset that has physical substance, more than minimal value, and is expected to be held by an enterprise for continued use or possession beyond the current accounting period for the services it yields.

(b) The following modifications of definitions set forth in Part 400 of this chapter are applicable to this standard: None.

[37 FR 22683, Dec. 14, 1972, as amended at 38 FR 30730, Nov. 7, 1973]

**PREAMBLES:** For preambles to amendments to § 403.30, see preambles A and B of the supplement to this part.

**§ 403.40 Fundamental requirement.**

(a) (1) Home office expenses shall be allocated on the basis of the beneficial or causal relationship between supporting and receiving activities. Such expenses shall be allocated directly to segments to the maximum extent practical. Expenses not directly allocated, if significant in amount and in relation to total home office expenses, shall be grouped in logical and homogeneous expense pools and allocated pursuant to paragraph (b) of this section. Such allocations shall minimize to the extent practical the amount of expenses which may be categorized as residual (those of managing the organization as a whole). These residual expenses shall be allocated pursuant to paragraph (c) of this section.

(2) No segment shall have allocated to it as an indirect cost, either through a homogeneous expense pool, or the residual expense pool, any cost, if other costs incurred for the same purpose have been allocated directly to that or any other segment.

(b) The following subparagraphs provide criteria for allocation of groups of home office expenses.

(1) *Centralized service functions.* Expenses of centralized service functions performed by a home office for its segments shall be allocated to segments on the basis of the service furnished to or received by each segment. Centralized service

functions performed by a home office for its segments are considered to consist of specific functions which, but for the existence of a home office, would be performed or acquired by some or all of the segments individually. Examples include centrally performed personnel administration and centralized data processing.

(2) *Staff management of certain specific activities of segments.* The expenses incurred by a home office for staff management or policy guidance functions which are significant in amount and in relation to total home office expenses shall be allocated to segments receiving more than a minimal benefit over a base, or bases, representative of the total specific activity being managed. Staff management or policy guidance to segments is commonly provided in the overall direction or support of the performance of discrete segment activities such as manufacturing, accounting, and engineering (but see paragraph (b)(6) of this section).

(3) *Line management of particular segments or groups of segments.* The expense of line management shall be allocated only to the particular segment or group of segments which are being managed or supervised. If more than one segment is managed or supervised, the expense shall be allocated using a base or bases representative of the total activity of such segments. Line management is considered to consist of management or supervision of a segment or group of segments as a whole.

(4) *Central payments or accruals.* Central payments or accruals which are made by a home office on behalf of its segments shall be allocated directly to segments to the extent that all such payments or accruals of a given type or class can be identified specifically with individual segments. Central payments or accruals are those which but for the existence of a number of segments would be accrued or paid by the individual segments. Common examples include centrally paid or accrued pension costs, group insurance costs, State and local income taxes and franchise taxes, and payrolls paid by a home office on behalf of its segments. Any such types of payments or accruals which cannot be identified specifically with individual segments shall be

allocated to benefited segments using an allocation base representative of the factors on which the total payment is based.

(5) *Independent research and development costs and bid and proposal costs.* Independent research and development costs and bid and proposal costs of a home office shall be allocated in accordance with 4 CFR Part 420.

(6) *Staff management not identifiable with any certain specific activities of segments.* The expenses incurred by a home office for staff management, supervisory, or policy functions, which are not identifiable to specific activities of segments shall be allocated in accordance with paragraph (c) of this section as residual expenses.

(c) *Residual expenses.* (1) All home office expenses which are not allocable in accordance with paragraph (a) of this section and paragraphs (1) through (5) of paragraph (b) of this section shall be deemed residual expenses. Typical residual expenses are those for the chief executive, the chief financial officer, and any staff which are not identifiable with specific activities of segments. Residual expenses shall be allocated to all segments under a home office by means of a base representative of the total activity of such segments, except where paragraph (c) (2) or (3) of this section applies.

(2) Residual expenses shall be allocated pursuant to paragraph (1) of § 403.50(c) if the total amount of such expenses for the contractor's previous fiscal year (excluding any unallowable costs and before eliminating any amounts to be allocated in accordance with paragraph (c)(3) of this section) exceeds the amount obtained by applying the following percentage(s) to the aggregate operating revenue of all segments for such previous year:

3.35 percent of the first \$100 million;  
0.95 percent of the next \$200 million;  
0.30 percent of the next \$2.7 billion;  
0.20 percent of all amounts over \$3 billion.

The determination required by this paragraph for the 1st year the contractor is subject to this Standard shall be based on

the pro forma application of this Standard to the home office expenses and aggregate operating revenue for the contractor's previous fiscal year.

(3) Where a particular segment receives significantly more or less benefit from residual expenses than would be reflected by the allocation of such expenses pursuant to paragraph (c) (1) or (2) of this section (see § 403.50(d)), the Government and the contractor may agree to a special allocation of residual expenses to such segment commensurate with the benefits received. The amount of a special allocation to any segment made pursuant to such an agreement shall be excluded from the pool of residual expenses to be allocated pursuant to paragraph (c) (1) or (2) of this section, and such segment's data shall be excluded from the base used to allocate this pool.

[37 FR 22683, Dec. 14, 1972, as amended at 44 FR 55127, Sept. 25, 1979]

**PREAMBLE:** For preamble relating to § 403.40(b)(5), see Preamble A of the supplement to Part 420.

#### **§ 403.50 Techniques for application.**

(a) (1) Separate expense groupings will ordinarily be required to implement § 403.40. The number of groupings will depend primarily on the variety and significance of service and management functions performed by a particular home office. Ordinarily, each service or management function will have to be separately identified for allocation by means of an appropriate allocation technique. However, it is not necessary to identify and allocate different functions separately, if allocation in accordance with the relevant requirements of § 403.40(b) can be made using a common allocation base. For example, if the personnel department of a home office provides personnel services for some or all of the segments (a centralized service function) and also established personnel policies for the same segments (a staff management function), the expenses of both functions could be allocated over the same base, such as the number of

personnel, and the separate functions do not have to be identified.

(2) Where the expense of a given function is to be allocated by means of a particular allocation base, all segments shall be included in the base unless: (i) Any excluded segment did not receive significant benefits from, or contribute significantly to the cause of the expense to be allocated and, (ii) any included segment did receive significant benefits from or contribute significantly to the cause of the expense in question.

(b) (1) Section 403.60 illustrates various expense pools which may be used together with appropriate allocation bases. The allocation of centralized service functions shall be governed by a hierarchy of preferable allocation techniques which represent beneficial or causal relationships. The preferred representation of such relationships is a measure of the activity of the organization performing the function. Supporting functions are usually labor-oriented, machine-oriented, or space-oriented. Measures of the activities of such functions ordinarily can be expressed in terms of labor hours, machine hours, or square footage. Accordingly, costs of these functions shall be allocated by use of a rate, such as a rate per labor hour, rate per machine hour or cost per square foot, unless such measures are unavailable or impractical to ascertain. In these latter cases the basis for allocation shall be a measurement of the output of the supporting function. Output is measured in terms of units of end product produced by the supporting function, as for example, number of printed pages for a print shop, number of purchase orders processed by a purchasing department, number of hires by an employment office.

(2) Where neither activity nor output of the supporting function can be practically measured, a surrogate for the beneficial, or causal relationship must be selected. Surrogates used to represent the relationship are generally measures of the activity of the segments receiving the service; for example, for personnel services reasonable surrogates would be number of personnel, labor hours, or labor dollars of the segments receiving the service. Any surrogate used should



be a reasonable measure of the services received and, logically, should vary in proportion to the services received.

(c) (1) Where residual expenses are required to be allocated pursuant to § 403.40(c)(2), the three factor formula described below must be used. This formula is considered to result in appropriate allocations of the residual expenses of home offices. It takes into account three broad areas of management concern: The employees of the organization, the business volume, and the capital invested in the organization. The percentage of the residual expenses to be allocated to any segment pursuant to the three factor formula is the arithmetical average of the following three percentages for the same period:

(i) The percentage of the segment's payroll dollars to the total payroll dollars of all segments.

(ii) The percentage of the segment's operating revenue to the total operating revenue of all segments. For this purpose, the operating revenue of any segment shall include amounts charged to other segments and shall be reduced by amounts charged by other segments for purchases.

(iii) The percentage of the average net book value of the sum of the segment's tangible capital assets plus inventories to the total average net book value of such assets of all segments. Property held primarily for leasing to others shall be excluded from the computation. The average net book value shall be the average of the net book value at the beginning of the organization's fiscal year and the net book value at the end of the year.

(d) The following paragraphs provide guidance for implementing the requirements of § 403.40(c)(3).

(1) An indication that a segment received significantly less benefit in relation to other segments can arise if a segment, unlike all or most other segments, performs on its own many of the functions included in the residual expense. Another indication may be that, in relation to its size, comparatively little or no costs are allocable to a segment pursuant to § 403.40(b)(1) through (5). Evidence of comparatively little

communication or interpersonal relations between a home office and a segment, in relation to its size, may also indicate that the segment receives significantly less benefit from residual expenses. Conversely, if the opposite conditions prevail at any segment, a greater allocation than would result from the application of § 403.40(c) (1) or (2) may be indicated. This may be the case, for example, if a segment relies heavily on the home office for certain residual functions normally performed by other segments on their own.

(2) Segments which may require special allocations of residual expenses pursuant to § 403.40(c)(3) include, but are not limited to foreign subsidiaries, GOCO's, domestic subsidiaries with less than a majority ownership, and joint ventures.

(3) The portion of residual expenses to be allocated to a segment pursuant to § 403.40(c)(3) shall be the cost of estimated or recorded efforts devoted to the segments.

(e) Home office functions may be performed by an organization which for some purposes may not be a part of the legal entity with which the Government has contracted. This situation may arise, for example, in instances where the Government contracts directly with a corporation which is wholly or partly owned by another corporation. In this case, the latter corporation serves as a "home office," and the corporation with which the contract is made is a "segment" as those terms are defined and used in this Standard. For purposes of contracts subject to this Standard, the contracting corporation may only accept allocations from the other corporation to the extent that such allocations meet the requirements set forth in this Standard for allocation of home office expenses to segments.

[37 FR 4173, Feb. 29, 1972, as amended at 43 FR 9781, Mar. 10, 1978]

**PREAMBLES:** For preambles relating to § 403.50, see preambles A and B of the supplement to this part. For the preamble on the deletion of § 403.50(c)(2), see preamble J of the supplement to Part 331.

### § 403.60 Illustrations.

(a) The following table lists some typical pools, together with illustrative allocation bases which could be used in appropriate circumstances:

Home office expense or function	Illustrative allocation bases
Centralized service functions: .....	
1. Personnel administration .....	1. Number of personnel, labor hours, payroll, number of hires.
2. Data processing services .....	2. Machine time, number of reports.
3. Centralized purchasing and subcontracting .....	3. Number of purchase orders, value of purchases, number of items.
4. Centralized warehousing .....	4. Square footage, value of material, volume.
5. Company aircraft service .....	5. Actual or standard rate per hour, mile, passenger mile, or similar unit.
6. Central telephone service .....	6. Usage costs, number of instruments.

(b) The selection of a base for allocating centralized service functions shall be governed by the criteria established in § 403.50(b).

(c) The listed allocation bases in this section are illustrative. Other bases for allocation of home office expenses to segments may be used if they are substantially in accordance with the beneficial or causal relationships outlined in § 403.40.

Home office expense or function	Illustrative allocation bases
Staff management of specific activities:	
1. Personnel management .....	1. Number of personnel, labor hours, payroll, number of hires.
2. Manufacturing policies (quality control, industrial engineering, production, scheduling, tooling, inspection and testing, etc.)	2. Manufacturing cost input, manufacturing direct labor.

Home office expense or function	Illustrative allocation bases
3. Engineering policies .....	3. Total engineering costs, engineering direct labor, number of drawings.
4. Material/purchasing policies....	4. Number of purchase orders, value of purchases.
5. Marketing policies .....	5. Sales, segment marketing costs.
Central payments or accruals:	
1. Pension expenses .....	1. Payroll or other factor on which total payment is based.
2. Group insurance expenses .....	2. Payroll or other factor on which total payment is based.
3. State and local income taxes and franchise taxes .....	3. Any base or method which results in an allocation that equals or approximates a segment's proportionate share of the tax imposed by the jurisdiction in which the segment does business, as measured by the same factors used to determine taxable income for that jurisdiction.

### § 403.70 Exemptions.

(a) Any contractor or subcontractor which together with its subsidiaries did not receive net awards of negotiated national defense prime contracts during Federal fiscal year 1971 (July 1, 1970, through June 30, 1971) totaling more than \$30 million is exempt from this Standard. This exemption expires on March 10, 1978. Any contractor, unless otherwise exempt, who receives a negotiated national defense contract after March 10, 1978, shall be required to comply at the start of his first cost accounting period following receipt of that award.

(b) This standard shall not apply to contractors who are subject to the provisions of Federal Management Circular 74-4 (Principles for Determining Costs Applicable to Grants and Contracts with State and Local Governments).

[37 FR 4173, Feb. 29, 1972, as amended at 40 FR 32749, Aug. 4, 1975; 42 FR 45629, Sept. 12, 1977; 43 FR 24820, June 8, 1978]

**PREAMBLES:** For preamble affecting § 403.70, see preambles A, C, D, and E of the supplement to this part. For preamble to superseded regulations, see preamble B of the supplement to this part.

**§ 403.80 Effective date.**

(a) This standard shall be followed by each contractor as of the beginning of his next fiscal year after September 30, 1973. The effective date of this standard is July 1, 1973.

(b) The effective date of § 403.70(a) as amended is March 10, 1978.

[38 FR 7447, Mar. 22, 1973; as amended at 42 FR 45629, Sept. 12, 1977]

**PREAMBLES:** Preamble A of the supplement to this part explains how effective dates are determined. For preamble affecting § 403.80(b), see preamble D.

**COST ACCOUNTING STANDARDS BOARD  
STATEMENT OF OPERATING POLICIES,  
PROCEDURES AND OBJECTIVES MARCH 1973**

**38 Fed. Reg. 6122, Cost Accounting Standards Guide  
(CCH) ¶ C032 (1973)**

**[Purpose]**

The purpose of this Statement is to present the operating policies, procedures and objectives within which the Cost Accounting Standards Board is formulating Cost Accounting Standards and related rules and regulations in carrying out its legislative mandate under Public Law 91-379.

This document does not deal with Board regulations related to written disclosures of cost accounting practices; such regulations are contained in 4 CFR 351.

The Board intends that this document improve general understanding of the Board's fundamental objectives and



concepts and thus provide the basis for productive dialogue with those concerned with the Board's work. Interested members of the public should, on the basis of this Statement, be better able to focus on the complex and difficult issues which the Board faces in promulgating future Cost Accounting Standards. The Statement is not intended to be final or all-encompassing; the Board may from time to time amplify, supplement or modify its views as it proceeds with consideration of individual issuances.

Although not every Board member is in full agreement with every policy, procedure and objective set out in this document, the Board is in agreement that the document provides a useful, overall framework within which it can develop specific Cost Accounting Standards. In the few cases where individual members may have differing views, they may set forth these views and the reasons for them if it becomes appropriate to do so in the context of the Board's consideration of a particular Cost Accounting Standard, rule or regulation.

Elmer B. Staats  
Chairman

### Objectives

A Cost Accounting Standard is a statement formally issued by the Cost Accounting Standards Board that (1) enunciates a principle or principles to be followed, (2) establishes practices to be applied, or (3) specifies criteria to be employed in selecting from alternative principles and practices in estimating, accumulating, and reporting costs of contracts subject to the rules of the Board. A Cost Accounting Standard may be stated in terms as general or as specific as the Cost Accounting Standards Board considers necessary to accomplish its purpose.

With respect to Cost Accounting Standards, the Board's primary goal is to issue clearly stated Cost Accounting Standards to achieve (1) an increased degree of uniformity in accounting practices among Government contractors, and

(2) consistency in accounting treatment of costs by individual Government contractors.

Increased uniformity and consistency in accounting are desirable to the extent they improve understanding and communication, reduce the incidence of disputes and disagreements, and facilitate equitable contract settlements.

### **Allocability and Allowability**

Allocability is an accounting concept affecting the ascertainment of contract cost; it results from a relationship between a cost and a cost objective such that the cost objective appropriately bears all or a portion of the cost. To be charged with all or part of a cost, a cost objective should cause or be an intended beneficiary of the cost.

Allowability is a procurement concept affecting contract price and in most cases is expressly provided in regulatory or contractual provisions. An agency's policies in allowability of costs may be derived from law and are generally embodied in its procurement regulations.

### **Operating Policies**

The following descriptions of policies show a number of important considerations which will be relevant to the Board as it seeks the objectives discussed previously.

#### **Relationship to Other Authoritative Bodies**

A number of authoritative bodies have been established to issue pronouncements affecting accounting and financial reporting. The Cost Accounting Standards Board views its work as relating directly to the preparation, use, and review of accounting data in the negotiation, administration, and settlement of negotiated defense contracts. The Board is the only body established by law with the specific responsibility to promulgate Cost Accounting Standards. Furthermore, its Cost Accounting Standards have the force and effect of law.

### **Cost Allocation Concepts**

The Board's primary goal is increased uniformity and consistency in treatment of costs as they are related to

negotiated defense contracts. Set forth herein are discussions of a number of important concepts which the Board will use in developing Cost Accounting Standards.

Cost accounting for negotiated Government contracts has long been on the basis of full allocation of costs, including general and administrative expenses and all other indirect costs. The allocation of all period costs to the products and services of the period is not a common practice either for public reporting or for internal management purposes; yet this has long been the established cost principle for costing defense procurement. The Board will adhere to the concept of full absorption costing wherever appropriate.

A cost objective is "a function, organizational subdivision, contract, or other work unit for which cost data are desired and for which provision is made to accumulate and measure the cost of processes, products, jobs, capitalized projects, etc." This definition has been promulgated by the Board.

Cost accounting systems are developed to provide a means for assigning all costs to appropriate cost objectives. Under the full costing concept, all costs initially allocated to intermediate cost objectives are reallocated to final cost objectives. Costs which are identified for special treatment (unreasonable costs, or costs unallowable for other reasons) may be assigned to final cost objectives established for that purpose.

Even with the foregoing concept, there are occasional difficult questions as to whether specified units of an organization or its work should be allocated cost on a full costing basis. The Board will attempt to identify and dispose of such questions in individual Cost Accounting Standards.

#### **Direct Identification of Costs**

As an ideal, each item of cost should be assigned to the cost objective which was intended to benefit from the resource represented by the cost or, alternatively, which caused incurrence of the cost. To approach this goal, the Board believes in the desirability of direct identification of costs with final cost objectives to the extent practical. The

Board recognizes the need for care in application of the concept of direct identification of costs with final cost objectives. Therefore, Cost Accounting Standards developed by the Board will reflect the desire for direct identification of cost and at the same time provide safeguards (such as those of 4 CFR 402) to assure consistency and objectivity in allocating costs incurred for the same purpose.

### **Hierarchy For Allocating Cost Pools**

Costs not directly identified with final cost objectives should be grouped into logical and homogeneous expense pools and should be allocated in accordance with a hierarchy of preferable techniques. The costs of like functions have a direct and definitive relationship to the cost objectives for which the functions are performed and the grouping of such costs in homogeneous pools for allocation to benefiting cost objectives results in better identification of cost with cost objectives.

The Board believes there is a hierarchy of preferable allocation techniques for distributing homogeneous pools of cost. The preferred representation of the relationship between the pooled cost and the benefiting cost objectives is a measure of the activity of the function represented by the pool of cost. Measures of the activities of such functions ordinarily can be expressed in such terms as labor hours, machine hours, or square footage. Accordingly, costs of these functions can be allocated by use of a rate, such as a rate per labor hour, rate per machine hour or cost per square foot, unless such measures are unavailable or impractical to ascertain. In these latter cases, the basis for allocation can be a measurement of the output of the supporting function. Output is measured in terms of units of end product produced by the supporting functions, as for example, number of printed pages for a print shop, number of purchase orders processed by a purchasing department, number of hires by an employment office.

Where neither activity nor output of the supporting function can be measured practically, a surrogate for the beneficial or causal relationship should be selected. Surrogates used to represent the relationship are generally measures of activity of the cost objectives receiving the

service. Any surrogate used should be a reasonable measure of the services received and should vary in proportion to the services received.

Pooled costs which cannot readily be allocated on measures of specific beneficial or causal relationship generally represent the cost of overall management activities. These costs should be grouped in relation to the activities managed and the base selected to measure the allocation of these indirect costs to cost objectives should be a base representative of the entire activity being managed. For example, the total cost of plant activities managed might be a reasonable base for allocation of general plant indirect costs. The use of a portion of a total activity, such as direct labor costs or direct material costs only, as a substitute for a total activity base, is acceptable only if the base is a good representative of the total activity being managed.

**COST ACCOUNTING STANDARDS BOARD  
RESTATEMENT OF OBJECTIVES, POLICIES  
AND CONCEPTS MAY 1977**

**42 Fed. Reg. 25,752 Cost Accounting Standards Guide  
(CCH) ¶ 2915 (1977)**

In March 1973, the Cost Accounting Standards Board published a Statement of its operating policies, procedures and objectives within which the Board was formulating Cost Accounting Standards and related rules and regulations in carrying out its legislative mandate under Pub. L. 91-379. The Board published that document to improve general understanding of the Board's fundamental objectives and concepts. The Board stated at that time that it may from time-to-time amplify, supplement or modify its views as it proceeds with consideration of individual issuances.

The Board is now publishing a restatement of its objectives, policies and concepts. This publication is intended to make known the current views of the Cost Accounting Standards Board in these matters. Interested members of the public should, on the basis of this Statement, be better able to focus on the complex and difficult issues which the



Board faces in promulgating Cost Accounting Standards. Anticipating that the Board, from time-to-time, expects to revise this document, the Board welcomes the views of interested persons on the objectives, policies and concepts stated herein.

May 1977.

## OBJECTIVES

The primary objective of the Cost Accounting Standards Board is to implement Pub. L. 91-379 by issuing clearly stated Cost Accounting Standards to achieve (1) an increased degree of uniformity in cost accounting practices among Government contractors in like circumstances, and (2) consistency in cost accounting practices in like circumstances by individual Government contractors over periods of time. In accomplishing this primary objective, the Board takes into account the probable costs of implementation, including inflationary effects, if any, compared to the probable benefits of such Standards.

Increased uniformity and consistency in accounting improve understanding and communication, reduce the incidence of disputes and disagreements, and facilitate equitable contract settlements.

A Cost Accounting Standard is a statement formally issued by the Cost Accounting Standards Board that (1) enunciates a principle or principles to be followed, (2) establishes practices to be applied, or (3) specifies criteria to be employed in selecting from alternative principles and practices in estimating, accumulating, and reporting costs of contracts subject to the rules of the Board. A Cost Accounting Standard may be stated in terms as general or as specific as the Cost Accounting Standards Board considers necessary to accomplish its purpose.

## ALLOWABILITY AND ALLOCABILITY

The CASB does not determine categories or individual items of cost that are allowable. Allowability is a procurement concept affecting contract price and in most cases is established in regulatory or contractual provisions. An agency's policies on allowability of costs may be derived

from law and are generally embodied in its procurement regulations.

Allocability is an accounting concept involving the ascertainment of contract cost; it results from a relationship between a cost and a cost objective such that the cost objective appropriately bears all or a portion of the cost. For a particular cost objective to have allocated to it all or part of a cost there should exist a beneficial or causal relationship between the cost objective and the cost.

Cost Accounting Standards provide for the definition and measurement of costs, the assignment of costs to particular cost accounting periods, and the determination of the bases for the direct and indirect allocation of the total assigned costs to the contracts and other cost objectives of these periods. The use of Cost Accounting Standards has no direct bearing on the allowability of those individual items of cost which are subject to limitations or exclusions set forth in the contract or which are otherwise specified as unallowable by the Government.

### **COST ALLOCATION CONCEPTS**

In order to achieve increased uniformity and consistency in accounting for costs of negotiated defense contracts, Cost Accounting Standards should provide criteria for the allocation to cost objectives of the costs of resources used. As used in this discussion cost is the monetary value of the resources used. A cost objective as defined by the Board is "a function, organizational subdivision, contract, or other work unit for which cost data are desired and for which provision is made to accumulate and measure the cost of processes, products, jobs, capitalized projects, etc." Standards deal with all aspects of cost allocability, including:

1. The definition and measurement of costs which may be allocated to cost objectives.
2. The determination of the cost accounting period to which such costs are assignable, and
3. The determination of the methods by which costs are to be allocated to cost objectives.

The Board will adhere to the concept of full costing whenever appropriate. Full allocation of all costs of a period, including general and administrative expenses and all other indirect costs is considered by the Board generally to be the basis for determining the cost of negotiated defense contracts.

Under the full costing concept, all costs initially allocated to intermediate cost objectives must be subsequently reallocated to final cost objectives. For this purpose, a final cost objective may be established to include unreasonable costs or costs unallowable for other reasons. The bases selected for allocation of costs from intermediate cost objectives to final cost objectives are the devices used to associate costs with final cost objectives when such costs are not directly identifiable with those cost objectives. If the base selected is a reasonable measure of the relationship between the cost and cost objectives, the cost will be reasonably allocated to such cost objectives. The Board has referred to this conceptual relationship in Standards as the beneficial or causal relationship between costs and cost objectives. In addition to the expression of this concept, Standards define in appropriate circumstances what criteria should be used to select the allocation base which best expresses this conceptual relationship.

### **HIERARCHY FOR ALLOCATING COSTS**

As an ideal, each item should be assigned to the cost objective which was intended to benefit from the resource represented by the cost or, alternatively, which caused incurrence of the cost. To approach this goal, the Board believes in the desirability of direct identification of costs with final cost objectives where the following allocation characteristics exist:

1. The beneficial or causal relationship between the incurrence of cost and cost objectives is clear and exclusive.
2. The amount of resource used is readily and economically measurable.

However, if all items of cost incurred for the same purpose in like circumstances do not have these characteristics, then

none of these items should be identified directly with final cost objectives.

In addition, the Board recognizes that there are circumstances where although the units of resource used can be directly identified with a final cost objective, it would be inappropriate or unnecessary to directly identify the cost with the final cost objective. Where the units of resource used are interchangeable, as for example in the use of like machinery and equipment, consumption of materials and supplies or utility services, the amount of cost to be allocated to cost objectives may more appropriately be determined on the basis of an average cost and not on the actual cost of each unit used. The Board believes that this averaging concept should be applied in appropriate circumstances. Individual Standards treat with specific instances where, although the incidence of resource use is directly identified with particular final cost objectives, the cost of the resource used should be determined on an averaging or indirect basis.

Where units of resource used are not directly identified with final cost objectives, the cost of such resources should be grouped into logical and homogeneous pools for allocation to cost objectives in accordance with a hierarchy of preferable techniques. Homogeneity means that the costs of functions allocated by a single base have the same or a similar relationship to the cost objectives for which the functions are performed, and the grouping of such costs in homogeneous pools for allocation to benefited cost objectives results in a better identification of cost with cost objectives. There are circumstances where unlike functions will have the same or a similar relationship to cost objectives: it may be appropriate to group the cost of such functions and use a measure of the common relationship as the base for cost allocation purposes. Finally, where the final output of either goods or services is the same or similar (i.e., homogeneous), all indirect functions attributable to the common output may be grouped for allocation of the costs of those functions.

The Board believes that the preferable allocation techniques for distributing homogeneous pools of cost are as follows:

1. The preferred representation of the relationship between the pooled cost and the benefiting cost objectives is a measure of the activity (input) of the function or functions represented by the pool of cost. This relationship can be measured in circumstances where there is a direct and definitive relationship between the function or functions and the benefiting cost objectives. In such cases, a single unit of measure can generally represent the consumption of resources in performance of the activities represented by the pool of cost. Measures of the activity ordinarily can be expressed in such terms as labor hours, machine hours, or square footage. Accordingly, costs of these functions can be allocated by use of a rate, such as a rate per labor hour, rate per machine hour or cost per square foot of the support activity.

2. Where such measures are unavailable or impractical to ascertain the basis for allocation can be a measurement of the output of the function or functions represented by the pool of cost. Thus the output becomes a substitute measure for the use of resources and is a reasonable alternative where direct measurement of input is [sic] impractical. Output can be measured in terms of units of end product produced by the functions, as for example, number of printed pages for a print shop, number of purchase orders processed by a purchasing department, number of hires by an employment office.

3. Where neither activity (input) nor output of the functions can be measured practically, a surrogate must be used to measure the resources used. Surrogates used to represent the relationship generally measure the activity of the cost objectives receiving the service and should vary in proportion to the services received. For example, a personnel department may provide various services which cannot be measured practically on an activity or output basis. Number of personnel served may reasonably represent the use of resources of the personnel function for the cost objectives receiving the service, where this base varies in proportion to the services performed.

4. Pooled costs which cannot readily be allocated on measures of specific beneficial or causal relationship generally represent the cost of overall management activities. Such



costs do not have a direct and definitive relationship to the benefiting cost objectives. These costs should be grouped in relation to the activities managed and the base selected to measure the allocation of these indirect costs to cost objectives should be a base representative of the entire activity being managed. For example, the total cost of plant activities managed might be a reasonable base for allocation of general plant indirect costs. The use of a portion of a total activity such as direct labor costs or direct material costs only, as a substitute for a total activity base, is acceptable only if the base is a good representative of the total activity being managed.

In developing allocation techniques for individual Standards, the Board will define the circumstances where direct identification or an appropriate level of the allocation hierarchy should be used.

### **ACCOUNTING STANDARDS AND THE FLOW OF COSTS**

Standards on cost allocation treat with the accounting for the flow of incurred costs as resources are used. The costs of resources used are initially allocated to a cost pool or to final cost objectives. The cost pools are intermediate cost objectives under the full costing concept of cost allocation as used by the Board. Cost pools are either service centers, overhead pools or general and administrative (G&A) cost pools. Costs are allocated from cost pools to other cost pools and to final cost objectives until all costs are accumulated in final cost objectives, thus determining the total cost of those final cost objectives. Costs accumulated in service center pools can be allocated to other service center pools, to overhead pools, to G&A pools and to final cost objectives. The costs accumulated in the overhead and G&A cost pools are allocated only to final cost objectives.

The particular distribution and cost flow characteristics of a cost pool can be identified by relating the cost flow concept described above with the hierarchy of preferable allocation techniques described previously. As stated, costs initially allocated to the various cost pools and final cost

objectives are costs which can be directly identified with those cost objectives. Cost pools which are identified as service centers normally will distribute their costs on a base which measures the activity or output of the service center and, as a result, these costs can be allocated to any cost objective benefitting from that service including other cost pools. Cost pools which are identified as overhead pools will distribute their costs using an allocation base which measures the total activity of a period. These costs are allocated only to cost objectives which ultimately reflect that total activity, i.e., the final cost objectives of a business unit.

As Standards are developed for the treatment of pools of cost, each pool is categorized either as a function of general support (e.g., overhead pool) or specific support (e.g., service center). The classification is determined by the type of allocation base and flow of cost that is prescribed for that pool.

### **OPERATING POLICIES**

The following descriptions of policies show a number of important considerations which will be relevant to the Board as it seeks the objectives discussed previously.

### **RELATIONSHIP TO OTHER AUTHORITATIVE BODIES**

A number of authoritative bodies have been established to issue pronouncements affecting accounting and financial reporting. The Cost Accounting Standards Board views its work as relating directly to the preparation, use, and review of cost accounting data in the negotiation, administration, and settlement of negotiated defense contracts. The Board is the only body established by law with the specific responsibility to promulgate Cost Accounting Standards. Furthermore, its Cost Accounting Standards have the force and effect of law in the negotiation, administration and settlement of defense contracts.

The accounting areas of interest to the Board which are also of interest to others for financial and tax accounting purposes are: (1) Definition and measurement of costs: (2) assignment of the cost of resources consumed to time periods:

and (3) allocation of direct labor, direct material, and indirect costs to the goods and services produced in a period.

The Cost Accounting Standards Board seeks to avoid conflict or disagreement with other bodies having similar responsibilities and will through continuous liaison make every reasonable effort to do so. The Board will give careful consideration to the pronouncements affecting financial and tax reporting, and in the formulation of Cost Accounting Standards it will take those pronouncements into account to the extent it can do so in accomplishing its objectives. The nature of the Board's authority and its mission, however, is such that it must retain and exercise full responsibility for meeting its objectives.

### FORMAT OF STANDARDS

The Board uses the same general format for all of its Standards to facilitate their use.

The "General Applicability" Section establishes the overall coverage of each Cost Accounting Standard. The "Purpose" Section normally provides a brief description of the goals of the Board in promulgating the Standard. The "Definition" Section reprints from the "Definitions" part of the Board's regulations, terms which are prominent in a particular Standard.

The "Fundamental Requirement" Section contains the broad principles or practices to be applied in accounting for the costs covered by the Standard.

The "Techniques for Application" Section provides criteria for the selection of alternative practices to implement the concepts contained in the "Fundamental Requirement." The techniques for application may describe the practices to be followed with respect to particular fundamental requirements or in particular circumstances. As a general rule, the techniques for application will narrow the accounting options in accordance with the concepts in the fundamental requirement. This Section may also provide special techniques for applying the concepts of the fundamental requirement to give consideration to materiality or special circumstances.

Examples of how the Standard is to operate in specific circumstances appear under "Illustrations." Usually this Section describes actual or hypothetical accounting practices and specifies whether or not such practices would comply with the provisions of the Standard. This Section may also illustrate specific practices which may be followed in particular circumstances.

The final two Sections of a Standard are "Exemptions." and "Effective Date." Where necessary, this format of a Standard may be supplemented by additional material, such as appendices, which also are an integral part of the Standard.

No one Section of a Standard stands alone, and all Sections must be read in the context of the Standard as a whole.

## PREFATORY COMMENTS

The Board prefaces its issuance of Standards, rules, and regulations with analytical comments to provide additional insight into the process by which the issuance was developed and the factors which led to the provisions set out in the issuance. The prefatory comments summarize the comments received in response to the initial publication and explain the reasons for any significant changes made as well as the reasons for not making changes which were suggested. Although these prefatory comments are not a formal part of any promulgation, they nonetheless are authoritative statements by the Board. As such, the Board encourages their use as aids in applying standards, rules, and regulations to specific situations.

## COST ACCOUNTING STANDARDS BOARD

### 4 CFR Part 403

[Interpretation No. 1]

Allocation of Home Office Expenses to Segments

45 Fed. Reg. 13,721 (1980)

AGENCY: Cost Accounting Standards Board.

ACTION: Final rule.

**SUMMARY:** The purpose of this interpretation is to clarify the intent of Cost Accounting Standard 403. Allocation of

Home Office Expenses to Segments, with respect to the way State and local income taxes and franchise taxes are to be allocated from a home office of a contractor to its segments.

**EFFECTIVE DATE:** March 3, 1980.

**FOR FURTHER INFORMATION CONTACT:** Bertoid Bodenheimer, Project Director, Cost Accounting Standards Board, 441 G Street, NW, Room 4836, Washington, DC 20548 (202) 275-5508.

**SUPPLEMENTARY INFORMATION:** Cost Accounting Standard (CAS) 403 was published in the Federal Register on December 14, 1972. Among other subjects, the Standard deals with the method of allocating to segments the State income tax or franchise tax which is levied on the contractor. Information available to the Cost Accounting Standards Board indicates that most contractors have been allocating the taxes involved in a manner that comports with the Board's intent. Some contractors, however, seeking to validate different methods, have appealed decisions of contracting officers to the Armed Services Board of Contract Appeals (ASBCA). These appeals have resulted in two decisions (McDonnell Douglas Corp., ASBCA No. 19842; Lockheed Corp., Lockheed Missiles and Space Group, Inc., ASBCA No. 22451) which have demonstrated that the Cost Accounting Standards Board's intent in CAS 403 has been misunderstood by the ASBCA. The misunderstanding, if not resolved promptly, will frustrate the intent of the Cost Accounting Standards Board and cause substantial problems in the administration of contracts being performed by those contractors who are applying the Standard as intended.

Because of the serious and widespread nature of the problems which will result if no action is taken, the Cost Accounting Standards Board has concluded that it is imperative to act immediately to set forth in unequivocal terms the intent of Cost Accounting Standard 403 as it relates to the allocation of income taxes and franchise taxes.

Notwithstanding this interpretation, the Cost Accounting Standards Board has determined that a general review of several Standards including Cost Accounting Standard 403



is appropriate. The review of CAS 403 will focus on the income tax allocation provisions and is expected to proceed on a priority basis. As a part of that project the Cost Accounting Standards Board may take further action with respect to tax allocation practices. Pending such action, however, the following interpretation being promulgated today sets forth the intent of the Board with respect to tax allocations under Cost Accounting Standard 403.

#### Appendix-Interpretation No. 1

Questions have arisen as to the requirements of Part 403, Cost Accounting Standard, Allocation of Home Office Expenses to Segments, for the purpose of allocating State and local income taxes and franchise taxes based on income (hereinafter collectively referred to as income taxes) from a home office of an organization to its segments.

By means of an illustrative allocation base in Section 403.60, the Standard provides that income taxes are to be allocated by "any base or method which results in an allocation that equals or approximates a segment's proportionate share of the tax imposed by the jurisdiction in which the segment does business, as measured by the same factors used to determine taxable income for that jurisdiction." This provision contains two essential criteria for the allocation of income taxes from home office to segments. First, the taxes of any particular jurisdiction are to be allocated only to those segments that do business in the taxing jurisdiction. Second, where there is more than one segment in a taxing jurisdiction, the taxes are to be allocated among those segments on the basis of "the same factors used to determine the taxable income for that jurisdiction." The questions that have arisen relate primarily to whether segment book income or loss is a "factor" for this purpose.

Most States tax a fraction of total organization income, rather than the book income of segments that do business within the State. The fraction is calculated pursuant to a formula prescribed by State statute. In these situations the book income or loss of individual segments is not a factor

used to determine taxable income for that jurisdiction. Accordingly, in States that tax a fraction of total organization income, rather than the book income on segments within the State, such book income is irrelevant for tax allocation purposes. Therefore, segment book income is to be used as a factor in allocating income tax expense from a home office to segments only where the amount is expressly used by the taxing jurisdiction in computing the income tax.

(Sec. 103, 84 Stat. 796; 50 U.S.C. App. 2168)

Arthur Schoenhaut

*Executive Secretary.*

[FR Doc. 80-6827 Filed 2-29-80; 8:45 am]

BILLING CODE 1620-01-M

## **COST ACCOUNTING STANDARDS BOARD**

### **4 CFR Part 403**

**Cost Accounting Standard; Allocation of Home Office Expenses to Segments**

**AGENCY:** Cost Accounting Standards Board.

**ACTION:** Proposed amendment.

**45 Fed. Reg. 49,573 (1980)**

**SUMMARY:** Cost Accounting Standard (CAS) 403, Allocation of Home Office Expenses to Segments, governs the allocation of the cost of state and local income taxes and franchise taxes from the home office of an organization to its segments. Experience with this Standard indicates that it has failed to accomplish its original goal of uniformity in the allocation of such costs. Consequently, the Board is proposing an amendment which requires a single method of allocating the cost of state and local income taxes and franchise taxes based on income.

**SUPPLEMENTARY INFORMATION:**

(1) Need for Amendment—The allocation of State and local income taxes and franchise taxes of an organization to its segments is governed by CAS 403. The way in which the Standard operates with respect to these taxes has been the subject of two recent Armed Services Board of Contract Appeals (ASBCA) decisions (McDonnell Douglas Corp., ASBCA No. 19842; Lockheed Corp., Lockheed Missiles and Space Group, Inc., ASBCA No. 22451). Both decisions were upheld upon the Government's Motion for Reconsideration.

It is clear from an analysis of the foregoing ASBCA decisions that the Standard has failed to accomplish its original goal of uniformity in State income tax allocations. In the McDonnell Douglas and Lockheed decisions, the ASBCA held that CAS 403 does not require the use of a single method for allocating state income taxes. Furthermore, by requiring consideration of segment income in the allocation of income taxes, the ASBCA permits the use of allocation techniques the Standard sought to preclude. Consequently the CASB has concluded that CAS 403 should be amended.

(2) Uniformity—The CASB "Restatement of Objectives, Policies and Concepts" (May 1977) stated that if the CASB were to be satisfied that circumstances among all concerned contractors are substantially the same in a given subject area, the CASB would not be precluded from establishing a single cost accounting treatment for use in such circumstances. The CASB remains convinced, as noted at the time it promulgated CAS 403, that the nature of State income tax expense is essentially the same for all companies and that therefore this expense should be allocated by the same techniques.

The single allocation method that the CASB is proposing today by means of an amendment to CAS 403 is the same as that which the CASB had intended to require under CAS 403 originally. However, the language has been revised to clarify the original intent. The CASB continues to be of the view, as it was at the time of the original promulgation of

CAS 403, that the proposed method allocates state income taxes on the basis of their beneficial or causal relationship to segments. The CASB believes it to be appropriate in this instance to select that single method which in its view best represents that relationship.

(3) Basis for Conclusions—In proposing this amendment, the Board was presented with various issues raised both before and after the promulgation of CAS 403 by a number of contractors, industry associations, ASBCA decisions, and other sources. These issues involved the allocation of tax costs generally and the allocation of state income taxes specifically. A summary of these issues is set forth below for the benefit of the readers.

*Community Service Theory of Allocating Taxes.* The proper allocation of tax costs from a home office to segments depends of course on the beneficial or causal relationship between such costs and the cost objectives. As stated in the Restatement of Objectives, Policies and Concepts, "As an ideal, each item should be assigned to the cost objective which was intended to benefit from the resource represented by the cost, or, alternatively, which caused incurrence of the cost." Consistent with this concept the first fundamental requirement of CAS 403 is that "Home office expenses shall be allocated on the basis of the beneficial or causal relationship between supporting and receiving activities."

The question of benefit from taxes has received long and extensive attention by both the ASBCA and the courts. A recurring argument on the part of at least 2 major aerospace contractors has been that local taxes pay for community services and that all work of a contractor benefits from these services. Furthermore, it is argued that if the taxing jurisdiction would not provide these services, the contractor would purchase at least some of the services on his own. In contrast, the ASBCA prior to CAS 403 took the following view:

"Appellants hypothesis of purchase (of services) is inapropos from any standpoint. Historically, general property taxes ad valorem are levied without relation to benefit\*\*\*. Actually for lack of other proximate relation,

personal property taxes would appear proper for distribution simply as a necessary expense according to the incidence of the tax, or in other words upon the assessment base." (1964 BCA 4056)

The Court of Claims, however, rejected the foregoing approach of the ASBCA to the benefit question. The court found that:

"This is a case in which 'benefit' has a general scope and that sufficient benefit has been shown\*\*\*. The cost of the California property tax was necessary to the overall operation of Lockheed's business in Burbank, California \* \* \*. The benefits flowed to government contracts on two levels. In a general way, they were benefited by the very fact that Lockheed was meeting its responsibilities as a corporate citizen in the Burbank community. Specifically they were benefited by the services provided by the community." (375 F.2d 786 (67))

More recently, the question of benefit from taxes was explored extensively by the ASBCA in its decision of tax allocations under CAS 403 (Boeing, ASBCA 19224). The ASBCA noted with apparent approval that one expert witness testified that trying to measure the benefit from the payment of taxes is a "matter of metaphysics." The ASBCA also noted that another expert had written that "In some instances, e.g., property taxes, it is impossible to measure a benefit; it can only be assumed." (Accounting for Defense Contracts, Prentice Hall, Inc., 1962 by Howard Wright.) Similarly, an article about two other ASBCA cases stated "The main point involved in summarizing these two cases is to emphasize the inadequacy of a pure benefit concept as criterion for allocating taxes based on income." (Benefit as a Criterion for Indirect Cost Allocation, The Federal Accountant, Vol. XXII, No. 3, Sep. 73 by Howard W. Wright and James P. Bedingfield.) The ASBCA acknowledged that the service provided by the state and other communities "is certainly a benefit." (Underscoring by the ASBCA.) It concluded however that this was not the benefit contemplated by CASB in adopting "an assessment base method" for allocating taxes.



Various tax allocation methods have also been justified on the basis [sic] of causative factors. With respect to property taxes, for example, it has been said that "The cause is the ownership of the property, the effect is the tax on such property \* \* \*. In cases in which a cause and effect relationship exists, the expense should be allocated to the several cost objectives in the same proportion that the cost objectives benefited from the use of the causative factors." (Accounting for Defense Contracts.) Those who believe that community services are the benefits from tax costs have consistently argued that the community's need for such services is the cause of the tax. The cause of state income taxes in particular, has been variously attributed to income or a company's presence in a state as further discussed in the following sections of this paper.

The various and conflicting theories as to the benefit from or cause of taxes make it particularly important that the allocation of their cost is covered by Standards. Under CAS 403, taxes would be allocated pursuant to Paragraph 403(b)(4), Central Payments or Accruals. Consistent with the Board's hierarchy for allocating costs, this paragraph requires that tax payments or accruals made by a home office on behalf of its segments be allocated directly to segments to the extent they can be identified specifically with individual segments. In the event such taxes cannot be identified specifically their cost must be allocated by means of a base representative of the factors on which the total payment is based. These provisions are considered to represent direct identification of the costs with benefiting cost objectives and obviate the need to determine the benefit from or cause of taxes in individual circumstances.

#### **Proposed Amendment to CAS 403**

##### **§ 403.50 [Amended]**

Insert the following new § 403.50(c) and redesignate the succeeding paragraphs accordingly:

\* \* \* \* \*

(c)(1) The criteria in § 403.40(b)(4) are to be applied to the allocation of State and local income taxes and franchise taxes based on income in accordance with this § 403.50(c).

(2) The taxes of any single taxing jurisdiction shall be allocated only to the segments that do business within that jurisdiction.

(3) An income tax or a franchise tax based on income shall be allocated directly to a segment in accordance with the first sentence of § 403.40(b)(4) if the tax cost can be identified specifically with a single segment. Such direct allocation would be required, for example, where a taxing jurisdiction accepts a separate income tax return by a segment, or where there is only one segment that does business within the taxing jurisdiction.

(4) Where a tax return for a taxing jurisdiction covers more than one segment that does business in that jurisdiction, the tax cost shall be allocated among these segments in accordance with the last sentence of § 403.40(b)(4). For purposes of allocating income taxes or franchise taxes based on income, the "factors on which the total payment is based" are (i) the fraction of total organization income which is taxed by the jurisdiction multiplied by (ii) the tax rate of the jurisdiction. Accordingly, each segment's share of the tax cost of a jurisdiction shall be determined by multiplying the segment's fraction of the total organization income by the State tax rate. A segment's fraction of total organization income shall be determined in the same way that the taxing jurisdiction makes this determination for the amount of total organization income to be taxed in that jurisdiction. For example, in a State which requires the determination of its fraction of total organization income as described in § 403.50(b), the fraction of total organization income for a segment that does business within the State would be the arithmetic average of three fractions, the numerators of which are the segment's payroll, sales and property and the denominators of which are the organization totals of each of these amounts. In those cases where the entire income of an organization is taxed by a single jurisdiction, the fraction of total organization income applicable to each segment in this jurisdiction shall be

**computed in the same way that the jurisdiction would require if that segment were part of an organization that does business in more than one jurisdiction.**

**PART 418—ALLOCATION OF DIRECT AND  
INDIRECT COSTS**

Sec.

- 418.10 General applicability.
- 418.20 Purpose.
- 418.30 Definitions.
- 418.40 Fundamental requirements.
- 418.50 Techniques for application.
- 418.60 Illustrations.
- 418.70 Exemptions.
- 418.80 Effective date.

**PREAMBLE A**

**AUTHORITY:** 84 Stat. 796, sec. 103 (50 U.S.C. App. 2168).

**SOURCE:** 45 FR 31932, May 15, 1980, unless otherwise noted.

**NOTE:** A supplement, consisting of the preamble to these regulations as they appeared in the **FEDERAL REGISTER**, follows the text of this part. This preamble is intended to explain the regulations in nontechnical language.

The preamble to the original publication of this part (45 FR 31929, May 15, 1980) is set forth in preamble A of the supplement.

OFR is interested in receiving comments from readers on this new format. Comments should be sent to: Office of the Federal Register, National Archives and Records Service, General Services Administration, Washington, D.C. 20408.

**§ 418.10 General applicability.**

General applicability of this Cost Accounting Standard is established by § 331.30 of the Board's regulations on applicability, exemption, and waiver of the requirements to include the Cost Accounting Standards contract clause in negotiated defense prime contracts and subcontracts (4 CFR 331.30).

**§ 418.20 Purpose.**

The purpose of this Cost Accounting Standard is (a) to provide for consistent determination of direct and indirect

costs, (b) to provide criteria for the accumulation of indirect costs, including service center and overhead costs, in indirect cost pools, and (c) to provide guidance relating to the selection of allocation measures based on the beneficial or causal relationship between an indirect cost pool and cost objectives. Consistent application of these criteria and guidance will improve classification of costs as direct and indirect and the allocation of indirect costs.

#### **§ 418.30 Definitions.**

(a) The following are definitions of terms prominent in this Standard.

(1) *Allocate*. To assign an item of cost, or a group of items of cost, to one or more cost objectives. This term includes both direct assignment of cost and the reassignment of a share from an indirect cost pool.

(2) *Direct cost*. Any cost which is identified specifically with a particular final cost objective. Direct costs are not limited to items which are incorporated in the end product as material or labor. Costs identified specifically with a contract are direct costs of that contract. All costs identified specifically with other final cost objectives of the contractor are direct costs of those cost objectives.

(3) *Indirect cost*. Any cost not directly identified with a single final cost objective, but identified with two or more final cost objectives or with at least one intermediate cost objective.

(4) *Indirect cost pool*. A grouping of incurred costs identified with two or more cost objectives but not identified specifically with any final cost objective.

(b) The following modifications of definitions set fourth [sic] in Part 400 of this chapter are applicable to this Standard: None.

#### **§ 418.40 Fundamental requirements.**

(a) A business unit shall have a written statement of accounting policies and practices for classifying costs as direct or indirect which shall be consistently applied.



(b) Indirect costs shall be accumulated in indirect cost pools which are homogeneous.

(c) Pooled costs shall be allocated to cost objectives in reasonable proportion to the beneficial or causal relationship of the pooled costs to cost objectives as follows:

(1) If a material amount of the costs included in a cost pool are costs of management or supervision of activities involving direct labor or direct material costs, resource consumption cannot be specifically identified with cost objectives. In that circumstance, a base shall be used which is representative of the activity being managed or supervised.

(2) If the cost pool does not contain a material amount of the costs of management or supervision of activities involving direct labor or direct material costs, resource consumption can be specifically identified with cost objectives. The pooled cost shall be allocated based on the specific identifiability of resource consumption with cost objectives by means of one of the following allocation bases:

(i) A resource consumption measure, (ii) an output measure, or (iii) a surrogate that is representative of resources consumed. The base shall be selected in accordance with the criteria set out in § 418.50(e).

(d) To the extent that any cost allocations are required by the provisions of other Cost Accounting Standards, such allocations are not subject to the provisions of this Standard.

(e) This Standard does not cover accounting for the costs of special facilities where such costs are accounted for in separate indirect cost pools.

#### **§ 418.50 Techniques for application.**

(a) *Determination of direct cost and indirect cost.* (1) The business unit's written policy classifying costs as direct or indirect shall be in conformity with the requirements of this Standard.

(2) In accounting for direct costs a business unit shall use actual costs, except that:

(i) Standard costs for material and labor may be used as provided in 4 CFR Part 407, or

(ii) An average cost or pre-established rate for labor may be used provided that (A) the functions performed are not materially disparate and employees involved are interchangeable with respect to the functions performed, or (B) the functions performed are materially disparate but the employees involved either all work in a single production unit yielding homogeneous outputs, or perform their respective functions as an integral team.

Whenever average cost or pre-established rates for labor are used, the variances, if material, shall be disposed of at least annually by allocation to cost objectives in proportion to the costs previously allocated to these cost objectives.

(3) Labor or material costs identified specifically with one of the particular cost objectives listed in paragraph (d)(3) of this section shall be accounted for as direct labor or direct material costs.

*(b) Homogeneous indirect cost pools.* (1) An indirect cost pool is homogeneous if each significant activity whose costs are included therein has the same or a similar beneficial or causal relationship to cost objectives as the other activities whose costs are included in the cost pool. It is also homogeneous if the allocation of the costs of the activities included in the cost pool result in an allocation to cost objectives which is not materially different from the allocation that would result if the costs of the activities were allocated separately.

(2) An indirect cost pool is not homogeneous if the costs of all significant activities in the cost pool do not have the same or a similar beneficial or causal relationship to cost objectives and, if the costs were allocated separately, the resulting allocation would be materially different. The determination of materiality shall be made using the criteria provided in 4 CFR 331.71.

(3) A homogeneous indirect cost pool shall include all indirect costs identified with the activity to which the pool relates.

(c) *Change in Allocation Base.* No change in an existing indirect cost pool allocation base is required if the allocation resulting from the existing base does not differ materially from the allocation that results from the use of the base determined to be most appropriate in accordance with the criteria set forth in paragraphs (d) and (e) of this section. The determination of materiality shall be made using the criteria provided in 4 CFR 331.71.

(d) *Allocation measures for an indirect cost pool which includes a material amount of the costs of management or supervision of activities involving direct labor or direct material costs.* (1) The costs of the management or supervision of activities involving direct labor or direct material costs do not have a direct and definitive relationship to the benefiting cost objectives and cannot be allocated on measures of a specific beneficial or causal relationship. In that circumstance, the base selected to measure the allocation of the pooled costs to cost objectives shall be a base representative of the activity being managed or supervised.

(2) The base used to represent the activity being managed or supervised shall be determined by the application of the criteria below. All significant elements of the selected base shall be included.

(i) A direct labor hour base or direct labor cost base shall be used, whichever in the aggregate is more likely to vary in proportion to the costs included in the cost pool being allocated, except that

(ii) A machine hour base is appropriate if the costs in the cost pool are comprised predominantly of facility-related costs, such as depreciation, maintenance, and utilities, or

(iii) A units-of-production base is appropriate if there is common production of comparable units, or

(iv) A material cost base is appropriate if the activity being managed or supervised is a material-related activity.

(3) Indirect cost pools which include material amounts of the costs of management or supervision of activities involving direct labor or direct material costs shall be allocated to:

- (i) Final cost objectives;
- (ii) Goods produced for stock or product inventory;
- (iii) Independent research and development and bid and proposal projects;
- (iv) Cost centers used to accumulate costs identified with a process cost system (i.e., process cost centers);
- (v) Goods or services produced or acquired for other segments of the contractor and for other cost objectives of a business unit; and
- (vi) Self-construction, fabrication, betterment, improvement, or installation of tangible capital assets.

(e) *Allocation measures for indirect cost pools that do not include material amounts of the costs of management or supervision of activities involving direct labor or direct material costs.* Homogeneous indirect cost pools of this type have a direct and definitive relationship between the activities in the pool and benefiting cost objectives. The pooled costs shall be allocated using an appropriate measure of resource consumption. This determination shall be made in accordance with the following criteria taking into consideration the individual circumstances:

(1) The best representation of the beneficial or causal relationship between an indirect cost pool and the benefiting cost objectives is a measure of resource consumption of the activities of the indirect cost pool.

(2)(i) If consumption measures are unavailable or impractical to ascertain, the next best representation of the beneficial or causal relationship for allocation is a measure of the output of the activities of the indirect cost pool. Thus, the output is substituted for a direct measure of the consumption of resources.

(ii) The use of the basic unit of output will not reflect the proportional consumption of resources in circumstances in which the level of resource consumption varies among the units of output produced. Where a material difference will result, either the output measure shall be modified or more

than one output measure shall be used to reflect the resources consumed to perform the activity.

(3) If neither resources consumed nor output of the activities can be measured practically, a surrogate that varies in proportion to the services received shall be used to measure the resources consumed. Generally, such surrogates measure the activity of the cost objectives receiving the service.

(4) Allocation of indirect cost pools which benefit one another may be accomplished by use of (i) the cross-allocation (reciprocal) method, (ii) the sequential method, or (iii) another method the results of which approximate those achieved by either of the methods in paragraph (e)(4)(i) or paragraph (e)(4)(ii) of this section.

(5) Where the activities represented by an indirect cost pool provide services to two or more cost objectives simultaneously, the cost of such services shall be prorated between or among the cost objectives in reasonable proportion to the beneficial or causal relationship between the services and the cost objectives.

(f) *Special allocation.* Where a particular cost objective in relation to other cost objectives receives significantly more or less benefit from an indirect cost pool than would be reflected by the allocation of such costs using a base determined pursuant to paragraphs (d) and (e) of this section, the Government and contractor may agree to a special allocation from that indirect cost pool to the particular cost objective commensurate with the benefits received. The amount of a special allocation to any such cost objective made pursuant to such an agreement shall be excluded from the indirect cost pool and the particular cost objective's allocation base data shall be excluded from the base used to allocate the pool.

(g) *Use of pre-established rates for indirect costs.* (1) Pre-established rates, based on either forecasted actual or standard cost, may be used in allocating an indirect cost pool.

(2) Pre-established rates shall reflect the costs and activities anticipated for the cost accounting period except



as provided in paragraph (g)(3) of this section. Such pre-established rates shall be reviewed at least annually, and revised as necessary to reflect the anticipated conditions.

(3) The contracting parties may agree on pre-established rates which are not based on costs and activities anticipated for a cost accounting period. The contractor shall have and consistently apply written policies for the establishment of these rates.

(4) Under paragraphs (g)(2) and (3) of this section where variances of a cost accounting period are material, these variances shall be disposed of by allocating them to cost objectives in proportion to the costs previously allocated to these cost objectives by use of the pre-established rates.

(5) If pre-established rates are revised during a cost accounting period and if the variances accumulated to the time of the revision are significant, the costs allocated to that time shall be adjusted to the amounts which would have been allocated using the revised pre-established rates.

#### **§ 418.60 Illustrations.**

(a) Business Unit A has various classifications of engineers whose time is spent in working directly on the production of the goods or services called for by contracts and other final cost objectives. In keeping with its written policy, detailed time records are kept of the hours worked by these engineers, showing the job/account numbers representing various cost objectives. On the basis of these detailed time records, Business Unit A allocates the labor costs of these engineers as direct labor costs of final cost objectives. This practice is in accordance with the requirements of § 418.50(a)(1).

(b) Business Unit B has a fabrication department, employees of which perform various functions on units of the work-in-process of multiple final cost objectives. These employees are grouped by labor skills and are interchangeable within the skill grouping. The average wage rate for each group is multiplied by the hours worked on each cost objective by employees in that group. The contractor



classifies these costs as direct labor costs of each final cost objective. This cost accounting treatment is in accordance with the provisions of § 418.50(a)(2)(B)(i).

(c) Business Unit C accumulates the costs relating to building ownership, maintenance, and utility into one indirect cost pool designated "Occupancy Costs" for allocation to cost objectives. Each of these activities has the same or a similar beneficial or causal relationship to the cost objectives occupying a space. Business Unit C's practice is in conformance with the provisions of § 418.50(b)(1).

(d) Business Unit D includes the indirect costs of machining and assembling activities in a single manufacturing overhead pool. The machining activity does not have the same or similar beneficial or causal relationship to cost objectives as the assembling activity. Also, the allocation of the cost of the machining activity to cost objectives would be significantly different if allocated separately from the costs of the assembling activity. Business Unit D's single manufacturing overhead pool is not homogeneous in accordance with the provisions of § 418.50(b), and separate pools must be established in accordance with § 418.40(b).

(e) In accordance with § 418.50(b)(3), Business Unit E includes all the cost of occupancy in an indirect cost pool. In selecting an allocation measure for this indirect cost pool, the contractor establishes that it is impractical to ascertain a measurement of the consumption of resources in relation to the use of facilities by individual cost objectives. An output base, the number of square feet of space provided to users, can be measured practically; however, the cost to provide facilities is significantly different for various types of facilities such as warehouse, factory, and office and each type of facility requires a different level of resource consumption to provide the same number of square feet of usable space. Allocation on a basic unit measure of square feet of space occupied will not adequately reflect the proportional consumption of resources. Business Unit E establishes a weighted square foot measure for allocating occupancy costs, which reflects the different levels of resource consumption required to provide the different types

of facilities. This practice is in conformance with provisions of § 418.50(e)(2)(B).

(f) Business Unit F has an indirect cost pool containing a significant amount of material-related costs. The contractor allocates these costs between his machining overhead cost pool and his assembly overhead cost pool. The business unit finds it impractical to use an allocation measure based on either consumption or output. The business unit selects a dollars of material-issued base which varies in proportion to the services rendered. The dollars of material-issued base is a surrogate base which conforms to the provisions of § 418.50(e)(3).

(g) Business Unit G has a machining activity for which it develops a separate overhead rate, using direct labor cost as the allocation base. The machining activity occasionally does significant amounts of work for other activities of the business unit. The labor used in doing the work for other activities is of the same nature as that used for contract work. However, the machining labor for other activities is not included in the base used to allocate the overhead costs of the machining activity. This practice is not in conformance with § 418.50(d)(2). Business Unit G must include the cost of labor doing work for the other activities in the allocation base for the machining activity indirect cost pool.

(h) Business Unit H accounts for the costs of company aircraft in a separate homogeneous indirect cost pool and allocates the cost to benefiting cost objectives using flight hours. Business Unit H prorates the cost of a single flight between benefiting cost objectives whenever simultaneous [sic] services have been rendered. Manager of Contract 2 learns of the trip and goes along with Manager of Contract 1. Business Unit H prorates the cost of the trip between Contract 1 and Contract 2. This practice is in conformity with the provision of § 418.50(e)(5).

(i) During a cost accounting period Business Unit I allocates the cost of its flight services indirect cost pool to other indirect cost pools and final cost objectives using a pre-established rate. The pre-established rate is based on an

estimate of the actual costs and activity for the cost accounting period. For the cost accounting period Business Unit I establishes a rate of \$200 per hour for use of the flight services activity. In March the contractor's operating environment changes significantly; the contractor now expects a significant increase in the cost of this activity during the remainder of the year. Business Unit I estimates the rate for the entire cost accounting period to be \$240 an hour. Pursuant to the provisions of § 418.50(g)(4), the Business Unit may revise its rate to the expected \$240 an hour. If the accumulated variances are significant, the business unit must also adjust the costs previously allocated to reflect the revised rates.

#### **§ 418.70 Exemptions.**

This standard shall not apply to contractors who are subject to the provisions of Federal Management Circular 74-4 (Principles for Determining Costs Applicable to Grants and Contracts with State and Local Governments).

#### **§ 418.80 Effective date.**

(a) The effective date of this Cost Accounting Standard is September 20, 1980.

(b) This Cost Accounting Standard shall be followed by each contractor on or after the start of his second fiscal year beginning after the receipt of a contract to which this Cost Accounting Standard is applicable.

### **PREAMBLE A**

#### **Preamble to Original Publication, 5-15-80**

The following is the preamble to the original publication of Part 418, 45 FR 31932, May 15, 1980.

### **SUMMARY**

The Cost Accounting Standards Board is promulgating today Cost Accounting Standard (CAS) 418, Allocation of Direct and Indirect Costs. It is one of a series of Standards the Board is issuing pursuant to Section 719 of the Defense

Production Act of 1950, as amended (Pub. L. 91-379, 50 U.S.C. App. 2168).

CAS 418 requires that costs be consistently classified as direct or indirect, establishes criteria for accumulating indirect costs in indirect cost pools, and sets forth guidance on allocating indirect cost pools. These topics are central to the Board's mission to issue Standards to achieve uniformity and consistency in the cost accounting practices followed by defense contractors in estimating, accumulating and reporting costs of defense contracts.

### **EFFECTIVE DATE**

September 20, 1980.

### **SUPPLEMENTARY INFORMATION:**

#### **(1) BACKGROUND**

The present Standard stems from two proposals, published in the FEDERAL REGISTER on March 16, 1978 and July 23, 1979.

The March 16, 1978 publication consisted of five proposed Standards:

- CAS 417—Distinguishing Between Direct and Indirect Costs.
- CAS 418—Allocation of Service Center Costs.
- CAS 419—Allocation of Material-Related Overhead Costs.
- CAS 420—Allocation of Manufacturing, Engineering and Comparable Overhead Costs.
- CAS 421—Allocation of Indirect Costs.

The Board received letters from 86 commentators on the March 16, 1978 publication. As a result of the comments and additional research performed at 10 contractor locations, the number of proposed Standards was reduced to three in the July 23, 1979 publication:

- CAS 417—Distinguishing Between Direct and Indirect Costs. (Continued as a separate Standard.)

- CAS 418—Allocation of Indirect Cost Pools. (Consolidated original CAS 418 and original CAS 421.)

- CAS 419—Allocation of Overhead Costs of Productive Functions and Productive Activities. (Consolidated original CAS 419 and original CAS 420.)

The Board received comments from 59 interested parties in response to the July 23, 1979 publication. In addition, representatives of three industry associations supplemented their views orally. After consideration of all views, the Board has determined that it is appropriate to reduce the degree of specificity contained in the July 23, 1979 publication. As a consequence, the Board has been able to consolidate the three proposed Standards into the one Standard being promulgated today.

The Board wishes to take this opportunity to express its appreciation for the helpful suggestions and constructive criticisms it has received and for the time devoted to assisting the Board in this endeavor by the many organizations and individuals involved.

The following sections of these prefatory comments present the Board's views on the major issues raised by the commentators in response to the July 23, 1979 publication, and explains how these views are expressed in the current Standard.

## **(2) POTENTIAL IMPACT ON CONTRACTOR ACCOUNTING SYSTEMS**

Based on staff research and the comments received on prior proposals, the Board recognizes that this Standard may have a pervasive impact on contractor accounting systems. Because of this, the Board here and in the Standard is emphasizing the necessity to evaluate any perceived need for change in cost accounting practices in terms of materiality. The need to evaluate the materiality of a change in cost accounting practice applies to all provisions of the

Standard. It is not limited to those particular provisions of the Standard in which materiality is mentioned for emphasis.

In resolving questions of materiality, the Board refers the parties to the criteria found in 4 CFR 331.71. These criteria take into consideration a variety of factors including the absolute dollar amount of costs involved, whether the costs are direct or indirect, the relationship of the costs to a particular contract, and the impact on Government funding. The Board is persuaded by the comments received on prior proposals that the use of these criteria will lead to an appropriate implementation of this Standard.

Some commentators urged the Board to define materiality in terms of the net effect on the cost of the totality of Government contracts in relation to the costs of implementing any accounting change pursuant to the Standard. The Board's materiality criteria recognize the need to consider the impact of cost accounting changes on the costs of individual contracts. To reduce the probable impact on the number of pools or changes in allocation bases required under the Standard however, the Board urges the parties to give special consideration to the net effect without ignoring any of the criteria specified in § 331.71(a). The Board notes that a change which has the same directional impact on most Government contracts will be more material than one in which the directional impacts on the costs of various Government contracts are mixed.

Commentators were particularly concerned that the proposed Standards would require them to establish separate indirect cost pools or the [sic] change their allocation bases even where the allocation results would be substantially the same. The Board intends that the creation of additional indirect cost pools or change of allocation base will be required only if the changes will result in materially different allocations of cost.

In those circumstances in which a change in cost accounting practice is not required because of the present immateriality of impact, the Board notes that the impact may become material if circumstances should change. In this



case acceptance of the existing system based on the immateriality of the impact would no longer pertain and the other criteria in the Standard would be applied to determine the appropriate accounting in the changed circumstances.

### (3) DEFINITION OF DIRECT COST

The Standard being promulgated today includes the Board's definition of direct cost (§ 418.30(a)(2)). The Board originally issued the definition in 1972 as part of CAS 402, Consistency in Allocating Costs Incurred for the Same Purpose. Direct cost is defined as "any cost which is specifically identified with a particular final cost objective."

Commentators have criticized the definition on conceptual grounds and on the basis that it is contrary to common understanding of the term. They contend that a proper approach would recognize that all cost objectives have direct costs. Despite these criticisms, they indicate that no practical problems have resulted from the present definition.

The definition in CAS 402 was needed because of the type of consistency the Board requires in that Standard; that is, consistency in the allocation of direct and indirect costs with respect to final cost objectives. To broaden the definition of direct cost to say that all cost objectives have direct costs, would require a substantial change in CAS 402 in order to continue to achieve the purposes of that Standard.

Furthermore, the existing definition of direct cost facilitates description of allocation bases for the purposes of the Standard being promulgated today, as well as for other Standards. A change in the definition of direct costs as recommended by the commentators would necessitate a series of new definitions or lengthy descriptions of the types of direct cost which may be used for making up bases for allocating various indirect cost pools.

The Board believes that the present definition of direct cost serves useful purposes and has not created any problems. The Board, therefore, has decided to retain the present definition.

#### (4) NEED FOR WRITTEN POLICIES

The purpose of proposed Standard 417 was to distinguish between direct and indirect costs. Criteria were established for direct costs. Generally, costs not meeting those criteria were to be classified as indirect.

Many commentators objected to the proposed Standard. They claimed that the criteria were too restrictive and would have required the reclassification from direct to indirect of many costs that have a close relationship to final cost objectives.

The Board has considered the statements made by the commentators and has studied other information it has developed. The Board has concluded that more flexibility should be allowed concerning the classification of costs as direct than was permitted by proposed CAS 417. That proposed Standard has been eliminated, and a requirement has been added to CAS 418 (§§ 418.40(a) and 418.50(a)(1)) for a written statement, in which each contractor must set forth his policies and practices for classifying costs as direct or indirect. The degree of detail that the statement should contain is a matter of decision by the contracting parties.

#### (5) AVERAGE AND PRE-ESTABLISHED DIRECT LABOR RATES

Proposed CAS 417 provided in § 417.50(b) that: "The amount of cost to be allocated as a direct cost to final cost objectives may be determined on the basis of an average cost of the resources used or applied whenever the resources are interchangeable." Several commentators believe that the requirement that resources be "interchangeable" before their costs could be averaged was too strict. They said that "interchangeable" would be interpreted to mean "identical." The principal concern was with average and pre-established direct labor rates. The commentators said that few labor resources are identical or even "productively interchangeable," and that consequently the interchangeability criterion would cause the creation of many more labor rates.

The Board believes there is no conceptual difference between average and pre-established direct labor rates and labor-rate standards, which are governed by CAS 407. Use of Standard Costs for Direct Material and Direct Labor. Retention of interchangeability as the sole criterion for average and pre-established direct labor rates would impose stricter criteria for those rates than CAS 407 imposes for labor-rate standards. Accordingly, the Board decided to apply the same criteria to average and pre-established direct labor rates that are used in CAS 407 for labor-rate standards. The Standard now permits (§ 418.50(a)(2)(B)) two kinds of groupings in addition to those based on the principle of interchangeability. Average or pre-established direct labor rates may be set for a group of employees who (i) are interchangeable with respect to functions performed, (ii) produce homogeneous output, or (iii) form an integral team. The Board believes that these changes will avoid the problems foreseen by the commentators, and will be consistent with CAS 407.

#### (6) BLANKET COSTS

Blanket costs are labor or material costs accumulated in intermediate cost objectives and reallocated to final cost objectives as direct costs. Many commentators objected to § 417.50(c) of the proposed CAS 417, which would have permitted such costs to be classified as direct only if they were allocated from an intermediate cost objective by a measure of resource consumption or a measure of output. Commentators said that this was too restrictive. They claimed that, since most bases used to distribute blanket costs are surrogates for rather than direct measures of resource consumption, proposed CAS 417 would have required most blanket costs to be classified as indirect costs.

The Board has considered the statements made by the commentators and has removed the requirement that blanket costs in order to be classified as direct costs be allocated on the basis of direct measures of consumption or output.

### **(7) 5 PERCENT MATERIALITY TEST**

A number of commentators expressed concern that the requirements of the proposed CAS 418 and 419 would lead to unnecessary proliferation of indirect cost pools. The proposed Standards would have required that a separate pool be created only where a material difference in cost allocation would result. The Board had proposed a 5 percent materiality test for this purpose. This provision drew a large number of responses. Most commentators expressed serious reservations about the practicality of such a test.

The 5 percent materiality test was included in the proposed CAS 419 for the express purpose of alleviating the concern expressed by many commentators about unnecessary proliferation of overhead pools. Many of the same commentators suggested that rather than specifying an arbitrary percentage, the Standard should rely on the materiality provision already included in the Board's rules and regulations. The Standard being promulgated today refers to § 331.71 which sets forth the materiality criteria for use in the application of all Standards.

### **(8) HOMOGENEOUS INDIRECT COST POOLS**

Some commentators stated that the requirement of the proposed § 418.50(a)(1) for a homogeneous indirect cost pool could result in unnecessary proliferation of indirect cost pools. A number of commentators also characterized the requirements of the proposed § 418.50(a)(2) as being redundant or in conflict with the requirements of the proposed § 418.50(a)(1). The Board has revised the proposed § 418.50(a)(2) to parallel the language in proposed § 418.50(a)(1) to preclude any conflict between the two paragraphs. The Board continues to believe that the requirement for homogeneous pools based on the concept of beneficial or causal relationship is essential. The Board has emphasized in the revised § 418.50(b)(2) that a pool also is deemed to be homogeneous if the separate allocation of the costs of the dissimilar activities would not result in material differences. The Board has provided reference to its guidance on materiality contained in § 331.71.

Some commentators stated that the proposed § 418.50(a)(3), which dealt with dissimilar use of resources, was too detailed a prescription and as such would lead to unnecessary proliferation of indirect cost pools. The Board was persuaded that the coverage of this level of detail is not necessary in the single revised Standard and accordingly has removed this requirement.

#### **(9) HIERARCHY OF ALLOCATION BASES**

The proposed CAS 418 provided, in § 418.50(b), a list of alternative allocation measures. The proposal would have required the use of the "best available" representation of resource consumption. Commentators questioned the need for an expressed preference and suggested a free choice among the allocation bases listed.

The Board believes that the establishment of the hierarchy is essential to assure that the basic concept of cost allocations as expressed by the Board in its statements of policy and in other Standards promulgated to date is achieved. The Board, however, made revisions to the Standard to lessen the concerns expressed by commentators. First, instead of the "best available representation of resource consumption," the Board has substituted therefor, in § 418.50(e), the phrase "an appropriate measure of resource consumption." The Board also provided that the determination of which allocation measures to be used must be made on the basis of the individual circumstances, including the availability and quality of the data on which the potential measures are based.

#### **(10) USE OF AN ALLOCATION BASE REPRESENTATIVE OF THE ACTIVITY BEING MANAGED OR SUPERVISED**

A number of commentators questioned when the fourth step of the hierarchy in the proposed CAS 418, a base representative of the activity being managed or supervised, was to be used. The Standard has been revised to provide more clearly that this type of base is to be used only to allocate indirect cost pools containing significant amounts of the costs of management or supervision of activities



involving direct labor or direct material cost, which are direct costs as defined by the Board. Therefore these cost pools are those which include the costs of managing and supervising final cost objectives or other cost objectives which are accounted for in a similar manner (those listed in § 418.50(d)(3)). A base representative of the activity being managed or supervised is not suitable for the allocation of the costs of management or supervision of activities involving only indirect costs.

For emphasis, the fourth step of the hierarchy has been set forth in a paragraph, § 418.50(d), separate and apart from the first three steps of the hierarchy (§ 418.50(e)) which should be used for allocating other indirect cost pools such as service centers.

#### **(11) CROSS-ALLOCATION AMONG INDIRECT COST POOLS**

The March 16, 1978 publication provided that only a cross-allocation or a sequential method could be used. In response to that proposal, commentators suggested that any method that would give the appropriate result be permitted.

The proposed CAS 418 in the July 23, 1979 publication provided for the use of any allocation method which would not result in significantly different allocation from that which would be obtained through using cross-allocation. A number of commentators stated that this provision was too complicated and costly. The Board continues to believe that the Standard should require the use of methods which would provide a reasonable representation of the beneficial or causal relationship existing among indirect cost pools. The Board was persuaded to broaden the test so that this relationship can be achieved by the use of any method that would approximate either the cross-allocation or the sequential method. Accordingly, revisions were made to § 418.50(e)(4) to permit such alternative methods.

#### **(12) CASUAL SALES**

A number of commentators suggested that the proposed CAS 418 should specifically allow casual sales of services



to be costed at other than full cost. Contractor definition and classification of sales as casual sales varies considerably among contractors. The Board has found no clear and consistent criteria for distinguishing these sales activities other than on the basis of materiality. The Board is of the opinion that for sales to be characterized as casual, they must be an immaterial part of the total activities of a cost pool. The Board expresses again its position that it will not deal with insignificant items of cost. Under the circumstances, the contracting parties can determine the acceptability of the costing methods to be used. Where sales represent a material part of the total activities of a cost pool, they cannot be deemed to be casual.

#### **(13) DEFINITION OF PRODUCTIVE ACTIVITY**

In the proposed CAS 419, the term "productive activity" was important to the determination of the number of pools which would be required for the allocation of overhead costs. Commentators expressed concern that the proposal would result in unnecessary proliferation of overhead pools because of the definition which was provided. The Standard has been revised to provide for the determination of the number of pools based on the concept of homogeneity.

#### **(14) ACCOUNTING FOR THE COSTS OF SPECIAL FACILITIES**

The Standard being promulgated today does not provide guidance for accounting for the costs of special facilities (e.g., space chambers, wind tunnels, reactors) accumulated in separate indirect cost pools. These assets usually do not have application to all of the work of a business unit, and this circumstance creates difficult questions concerning the appropriate cost allocation techniques to be applied. The Board recognizes a need for particular attention to the accounting for the limited number of special facilities involved and has established a project in this area to review the cost allocation issues.

**(15) DEGREE OF SPECIFICITY IN PROPOSED CAS 419**

As discussed previously, a large number of commentators expressed concern that the definition of "productive activity" and the 5 percent materiality test which were included in the proposed CAS 419 could result in unnecessary proliferation of overhead pools. A large number of commentators were also critical of the proposed CAS 419 because in their opinion it provided too great a degree of specificity. The requirements relative to separate overhead pools, the specific reference to the treatment of costs of special facilities, and the treatment of purchased labor and overtime premiums and shift differentials in allocation bases were considered by many commentators to be too procedural and detailed.

The Board was of the opinion that some degree of specificity would be desirable and necessary in this area to minimize differing interpretations by the contracting parties. In light of the number of criticisms on the specificity of the proposed CAS 419, however, the Board decided to remove the references to those terms and provisions. The elimination of these terms and provisions does not reflect a change in position concerning the appropriate accounting for the costs involved. Rather, in consolidating the proposed 417, 418 and 419 into a single CAS 418 being promulgated today, the Board is providing a more general Standard incorporating the basic concepts of cost allocation previously established in the Board's *Restatement of Objectives, Policies and Concepts*.

**(16) EVALUATION OF BENEFITS AND COSTS**

Many commentators asserted that the costs of implementing the proposed Standards would outweigh the benefits that would be derived from them. They were concerned that the Standards would require significant accounting changes because of the perceived detailed prescriptions in the Standard and for the potential implementation of changes in cost accounting practices where no material cost impact would result. The Board believes the Standard being promulgated today will

significantly reduce the anticipated costs of implementation as compared with the prior proposals. This has been accomplished by reducing the degree of specificity and by emphasizing the importance of materiality in determining when changes in cost accounting practices are required. These revisions should minimize the potential for excessive proliferation of cost pools. The Board notes that this Standard is applicable to a significant percentage of the total costs of negotiated defense contracts. The provisions of this Standard will provide greater assurance of uniformity and consistency in accounting for these costs than was previously available. The Board believes that the benefits of the increased uniformity and consistency in cost allocation which will result from the Standard outweigh the costs of implementation.

F-68

**DEFENSE PROCUREMENT CIRCULAR**

**4 MAY 1972**

**NUMBER 99**

This Defense Procurement Circular is issued by direction of the Assistant Secretary of Defense (Installations and Logistics) pursuant to the authority contained in 5 U. S. Code 301, 10 U. S. Code 2202, DOD Directive No. 4105.30, and ASPR 1-106.

All Armed Services Procurement Regulation material and other directive material published herein is effective upon receipt except as otherwise indicated.

Unless otherwise indicated in the introductory language preceding an item, each item in this Circular shall remain in effect until the effective date of that subsequent ASPR revision which incorporates the item, or until specifically canceled.

**Reproduction authorized.**

**CONTENTS**

<u>Item</u>	<u>Title</u>	<u>Page</u>
I	Cost Accounting Standards	2

**DEFENSE PROCUREMENT CIRCULAR****4 MAY 1972****NUMBER 99****ITEM I - COST ACCOUNTING STANDARDS**

Public Law 91-379, 50 U.S.C. App. 2168, as implemented by the Cost Accounting Standards Board (4 CFR Sec 331 *et. seq.*), requires the development of Cost Accounting Standards to be used in connection with negotiated national defense contracts and the disclosure of cost accounting practices to be used in such contracts.

The purpose of this item is to establish initial Department of Defense policies and procedures for compliance with this law and the regulations issued thereunder. Review and coordination procedures may be established by Departmental regulations.

Section III, Part 12 requires that the solicitation notice "Disclosure Statement - Cost Accounting Practices and Certification," in 3-501(b), Sec. B(xvi) and the contract clause, "Cost Accounting Standards," in 7-104.83 be inserted in all solicitations issued on or after 1 July 1972 which are likely to result in negotiated contracts exceeding \$100,000, except when the price is based on established catalog or market prices of commercial items sold in substantial quantities to the general public or prices set by law or regulation. In addition, the contract clause in 7-104.83 shall be inserted in all such negotiated contracts awarded on or after 1 October 1972 regardless of the solicitation date. (Although the solicitation notice and contract clause are not required in solicitations issued prior to 1 July 1972, it is recommended that they be included when it is contemplated that the contract will be awarded on or after 1 October 1972. If, in this situation, award is made prior to 1 October, the clause shall not be included in the contract.

The initial requirement by the Cost Accounting Standards Board for filing the Disclosure Statement applies only to a company which, together with its subsidiaries, received net awards of negotiated national defense prime contracts during the period 1 July 1970 through 30 June 1971

totaling more than \$30 million. Those contractors or subcontractors not receiving net prime awards in that amount during that period and therefore not required to file a Disclosure Statement with their proposals at this time shall submit a Certificate of Monetary Exemption.

Supplies of the Disclosure Statement Form, CASB-DS-1 will be furnished each Department by the Cost Accounting Standards Board so that distribution to contractors may be made through the Department's regular channels.

For the convenience of Government personnel and contractors, the text of the rules and regulations issued by the Cost Accounting Standards Board is attached hereto as ASPR Appendix O. To understand the new policies and procedures relating to Cost Accounting Standards, Appendix O should be read in its entirety.

1-406 - Add:

- (lix) determine adequacy of prime contractor's Disclosure Statements;
- (lx) determine whether prime contractor's Disclosure Statements are in compliance with Section XV and Cost Accounting Standards;
- (lxi) determine contractor compliance with Cost Accounting Standards and Disclosure Statements, if applicable; and
- (lxii) negotiate price adjustments and execute supplemental agreements pursuant to the Cost Accounting Standards clause in 7-104.83.

3-501(b), Sec. B - Add:

- (xvi) In accordance with 3-1203, the following notice:

**DISCLOSURE STATEMENT - COST ACCOUNTING  
PRACTICES AND CERTIFICATION**

Any contract in excess of \$100,000 resulting from this solicitation, except when the price negotiated is based on: (1) established catalog or market prices of commercial items sold in substantial quantities to the general public, or (2)



prices set by law or regulation, shall be subject to the requirements of the Cost Accounting Standards Board. Any offeror submitting a proposal, which, if accepted, will result in a contract subject to the requirements of the Cost Accounting Standards Board must, as a condition of contracting, submit a Disclosure Statement as required by regulations of the Board. The Disclosure Statement must be submitted as a part of the offeror's proposal under this solicitation (see (1) below) unless (i) the offeror, together with all divisions, subsidiaries, and affiliates under common control, did not receive net awards of negotiated defense prime contracts during the period 1 July 1970 through 30 June 1971 totaling more than \$30,000,000 (see (2) below), (ii) the offeror has already submitted a Disclosure Statement disclosing the practices used in connection with the pricing of this proposal (see (3) below), or (iii) post-award submission has been authorized by the Contracting Officer. CAUTION: A practice disclosed in a Disclosure Statement shall not, by virtue of such disclosure, be deemed to be a proper, approved, or agreed to practice for pricing proposals or accumulating and reporting contract performance cost data.

Check the appropriate box below:

**[ ] 1. CERTIFICATE OF CONCURRENT SUBMISSION OF DISCLOSURE STATEMENT(S)**

The offeror hereby certifies that he has submitted, as a part of his proposal under this solicitation, copies of the Disclosure Statement(s) as follows: (i) original and one copy to the cognizant Administrative Contracting Officer (ACO) (see DoD Directory of Contract Administration Components (DoD 4105.59H)); (ii) one copy to the cognizant contract auditor; and (iii) one copy to the Cost Accounting Standards Board, 441 G Street, N.W., Washington, D.C. 20548.

Date of	Name(s) and Address(es) of
<u>Disclosure Statement(s)</u>	<u>Cognizant ACO(s) Where Filed</u>

The offeror further certifies that practices used in estimating costs in pricing this proposal are consistent with the cost accounting practices disclosed in the Disclosure Statement(s).

[ ] **2.CERTIFICATE OF MONETARY EXEMPTION**

The offeror hereby certifies that, together with all divisions, subsidiaries, and affiliates under common control, he did not receive net awards of negotiated national defense prime contracts during 1 July 1970 through 30 June 1971 totaling more than \$30,000,000.

[ ] **3.CERTIFICATE OF PREVIOUSLY SUBMITTED DISCLOSURE STATEMENT(S)**

The offeror hereby certifies that the Disclosure Statement(s) were filed as follows:

<u>Date of</u>	<u>Name(s) and Address(es) of</u>
<u>Disclosure Statement(s)</u>	<u>Cognizant ACO(s) Where Filed</u>

The offeror further certifies that practices used in estimating costs in pricing this proposal are consistent with the cost accounting practices disclosed in the Disclosure Statement(s).

3-501(c) - Add:

- (li) in accordance with 3-1203, the notice entitled Disclosure Statement - Cost Accounting Practices and Certification in 3-501(b), Sec. B(xvi);

3-809(c) - Add:

(5) *Cost Accounting Standards Board Rules and Regulations*. In accordance with Section III, Part 12 - Cost Accounting Standards, and Section XV - Contract Cost Principles and Procedures, the cognizant contract auditor shall be responsible for making recommendations to the ACO as to whether:

- (i) a contractor's Disclosure Statement, submitted as a condition of contracting, adequately describes the actual or proposed cost accounting practices as required by P.L. 91-379, 50 U.S.C. App. 2168, as implemented by the Cost Accounting Standards Board;
- (ii) a contractor's disclosed cost accounting practices are in compliance with Section XV and applicable Cost Accounting Standards;
- (iii) a contractor's or subcontractor's failure to comply with applicable Cost Accounting Standards or to follow consistently his disclosed cost accounting practices has resulted, or may result in, any increased cost paid by the Government; and
- (iv) a contractor's or subcontractor's proposed price changes, submitted as a result of changes made to previously disclosed or established cost accounting practices, are fair and reasonable.

**Section III - Add:**

**Part 12 - Cost Accounting Standards**

**3-1200 *Cost Accounting Standards.***

3-1201 *General.* Public Law 91-379, 50 U.S.C. App. 2168, as implemented by the Cost Accounting Standards Board (see Appendix O) requires the development of Cost Accounting Standards to be used in connection with negotiated national defense contracts and disclosure of cost accounting practices to be used in such contracts.

3-1202 *Definitions.* When used in this Part, the words and terms defined in Appendix O shall have the meanings set forth therein. In addition, the words and terms defined in this paragraph shall have the meanings set forth below:

- (i) "Net awards" means the obligated value of negotiated national defense prime contracts, awarded in the reporting period, minus cancellations, terminations, and other credit transactions relating thereto.

- (ii) "Company" includes all divisions, subsidiaries, and affiliates of the contractor under common control.

**3-1203 *Prime Contractor Disclosure Statement(s).***

(a) *Solicitation Notice.* The notice entitled Disclosure Statement—Cost Accounting Practices and Certification in 3-501(b), Sec. B(xvi) shall be inserted in all solicitations which are likely to result in a negotiated contract exceeding \$100,000, except when the price is (i) based on established catalog or market prices of commercial items sold in substantial quantities to the general public, or (ii) set by law or regulation.

(b) *Pre-Award Submission of Disclosure Statement(s).* Each offeror submitting an offer which could result in a negotiated contract exceeding \$100,000 shall furnish copies of his Disclosure Statement(s) to the offices listed in paragraph (c) below concurrently with the submission of his proposal to the PCO except when the offeror has executed the Certificate of Monetary Exemption or the Certificate of Previously Submitted Disclosure Statement (see 3-501(b), Sec. B(xvi)). More than one Disclosure Statement may be required in connection with the award of a contract (see paragraph 351.4(a) of Appendix O). Award of a contract shall not be made until a determination has been made by the cognizant ACO that a Disclosure Statement is adequate (see 3-1205(a)) unless, in order to protect the interests of the Government, the PCO waives this requirement. In this event, a determination shall be made as soon after award as possible.

(c) *Distribution of Disclosure Statement(s).* The offeror shall distribute his Disclosure Statement(s) as follows:

- (i) Original and one copy to the cognizant Administrative Contracting Officer (ACO) (see DoD Directory of Contract Administration Components (DoD 4105.59H) unless otherwise specified in accordance with 3-1208);
- (ii) one copy to the cognizant contract auditor; and

- (iii) one copy to the Cost Accounting Standards Board, 441 G Street, N.W., Washington, D.C. 20548.

(d) *Post-Award Submission of Disclosure Statement(s).* Post-award submission of Disclosure Statement(s) may be authorized only when the PCO has made a written determination that such authorization is essential (i) to the national defense, (ii) because of the public exigency, or (iii) to avoid undue hardship. Each determination shall set forth facts which clearly support the determination to authorize post-award submission, and a copy of the determination shall be included in the contract file. Authorization issued pursuant to this paragraph shall specify the period of time, not to exceed 90 days after contract award, within which disclosure must be made.

(e) *Determination of Secretary that it is Impractical to Secure Disclosure Statement(s).* If the Assistant Secretary (Installations and Logistics) for a Military Department or the Director for the Defense Supply Agency, the Defense Communications Agency, the Defense Nuclear Agency, or the Defense Mapping Agency determines that it is impractical to secure the Disclosure Statement(s) in accordance with the clause in 7-104.83 and this Part, he may authorize award of such contract without obtaining such Statement(s). This authority shall not be delegated. He shall, within 30 days thereafter, submit a report to the Cost Accounting Standards Board, setting forth all material facts.

(f) *Privileged and Confidential Information in Disclosure Statement(s).* If the offeror or contractor notifies the contracting officer that the Disclosure Statement contains trade secrets and commercial or financial information which is privileged and confidential, the Disclosure Statement will be protected and will not be released outside the Government (see paragraph (a)(1) of the Cost Accounting Standards clause in 7-104.83).

(g) *Amendment of Disclosure Statements.* Amendments of a Disclosure Statement after contract award shall be processed in accordance with paragraph 351.12 of Appendix O and 3-1207.

**3-1204 Contract Clause.** The Cost Accounting Standards clause set forth in 7-104.83 shall be inserted in all negotiated contracts exceeding \$100,000, except when the price is based on established catalog or market prices of commercial items sold in substantial quantities to the general public or is set by law or regulation.

**3-1205 Review of Prime Contractor Disclosure Statements.**

(a) *ACO and Auditor Support Responsibility.* When DoD has contract administration cognizance of a contractor, required Disclosure Statements will be reviewed by the cognizant ACO and auditor for all Government agencies including, but not limited to, DoD, NASA, AEC, and GSA.

(b) *Determination of Adequacy.* The cognizant contract auditor shall perform an initial review of a Disclosure Statement to ascertain whether it adequately describes the offeror's cost accounting practices. In order to be deemed adequate, the Disclosure Statement must be current, accurate, and complete. Upon completion of this initial review the results shall be reported to the ACO. When the ACO determines that adequate disclosure has not been made, he shall identify the areas of inadequacy and request a revised Statement and so advise the auditor and PCO. When the ACO determines that the Disclosure Statement is adequate, he shall notify the offeror in writing with a copy to the auditor and the PCO. In addition, the notice shall state that a disclosed practice shall not, by virtue of such disclosure, be deemed to be a proper, approved, or agreed to practice for pricing proposals or accumulating and reporting contract performance cost data. The contract may be awarded when it is determined that an adequate disclosure has been made (see 3-1203(b)).

(c) *Determination of Compliance.* Subsequent to the issuance of the above notification, a more detailed review of the Disclosure Statement shall be made by the auditor to ascertain whether the disclosed practices are in compliance with Cost Accounting Standards and, for DoD procurements, with Section XV; the auditor shall advise the ACO of his



findings. When it is determined by the ACO that any disclosed practice is not in compliance, he shall so notify the offeror or contractor, with a copy to the auditor. This notice shall require the offeror or contractor to advise the ACO and the auditor of the corrective action taken or to be taken to bring the practices into compliance. A revised Disclosure Statement may be required. In addition, adjustment of the prime contract price or cost allowance in accordance with 3-1207(b) may be required. Non-compliance which cannot be resolved by the ACO should be referred to higher authority within the Department having contract administration cognizance and, if necessary, any other Department or Government agency concerned. The ACO shall advise the PCO of disclosed practices which are not in compliance which would have any effect on the price of contracts under negotiation.

### *3-1206 Subcontractor Disclosure Statements.*

(a) Disclosure Statements furnished by a subcontractor pursuant to the "Cost Accounting Standards" clause, should, except as provided in (b) or (c) below, be submitted to the prime contractor or higher tier subcontractor.

(b) A subcontractor may satisfy the requirement to submit Disclosure Statement(s) by identifying to the prime contractor or higher tier subcontractor the ACO to whom his Disclosure Statement was previously submitted.

(c) When a subcontractor considers that his Disclosure Statement contains information that is privileged and confidential, he may, with the approval of the prime contractor, submit it direct to the ACO and auditor having cognizance of the prime contractor's facility. The prime contractor ACO shall furnish copies to the ACO and auditor cognizant of the subcontractor for use in administration of the Cost Accounting Standards clause.

(d) Post-award submission of the subcontractor's Disclosure Statement (see 3-1203(d)) must be approved by the ACO having cognizance of the prime contractor.

(e) A determination that it is impractical to secure a subcontractor's Disclosure Statement must be made in accordance with 3-1203(e).

**3-1207 Contract Price Adjustments.**

(a) *Modifications to Disclosure Statements or Established Practices.* Paragraph (a)(4) of the Cost Accounting Standards clause (7-104.83) provides for adjustment of contract price under certain circumstances. The cognizant ACO is responsible for obtaining the contractor's proposal and for the conduct of all negotiations of such adjustments to all Government prime contracts. When a prime contractor is also a subcontractor, the ACO shall advise the ACO having cognizance of the applicable prime contract of the results of his negotiations.

(b) *Failure to Comply with "Cost Accounting Standards" Clause.* Paragraph (a)(5) of the Cost Accounting Standards clause (ASPR 7-104.83) provides for an adjustment of the prime contract price or cost allowance, as appropriate, if the contractor or a subcontractor fails to comply with an applicable cost accounting standard or fails to follow any disclosed accounting practice and such failure results in any increased cost paid by the Government. The cognizant contract auditor shall be responsible for the conduct of audits as necessary to disclose such failures. The cognizant ACO shall negotiate all resultant prime contract adjustments, including applicable interest.

(c) *Conduct of Negotiations and Execution of Supplemental Agreements.* Negotiations pursuant to (a) and (b) above shall be conducted on behalf of all Government agencies including, but not limited to, DoD, NASA, AEC, and GSA. The ACO shall invite purchasing offices to participate in negotiations of adjustments when the price of any of their contracts will be increased or decreased by \$10,000 or more. At the conclusion of negotiations the following actions shall be taken by the ACO:

(i) Execute supplemental agreements to DoD contracts. If additional funds are required, request them from the appropriate PCO.

(ii) Advise contracting officers of other Government agencies of the results of his negotiations. Such agencies shall execute necessary supplemental agreements in the amounts negotiated.

**3-1208 Contract Administration by Other Government Agencies.** In some instances the contracting officer cognizant of a contractor will be the representative of a Government agency other than DoD. A list of such assignments will be published from time to time in Defense Procurement Circulars. When prime contract awards are to be made to such contractors, Item 1 of the solicitation provision in 3-501 shall be modified by deleting the words "see DoD Directory of Contract Administration Components (DoD 4105.59H)" and inserting the appropriate address. Contracting officers of other Government agencies will perform for DoD all functions in 3-1205, 3-1206, and 3-1207 which DoD ACOs perform for other Government agencies.

7-104.83 - Add:

7-104.83 *Cost Accounting Standards.* In accordance with 3-1204, insert the following clause:

**COST ACCOUNTING STANDARDS (1972 JUL)**

(a) Unless the Cost Accounting Standards Board has prescribed rules or regulations exempting the contractor or this contract from standards, rules, and regulations promulgated pursuant to 50 U.S.C. App. 2168 (Public Law 91-379, August 15, 1970), the contractor, in connection with this contract shall:

(1) By submission of a Disclosure Statement, disclose in writing his cost accounting practices as required by regulations of the Cost Accounting Standards Board. The required disclosures must be made prior to contract award unless the Contracting Officer provides a written notice to the contractor authorizing post-award submission in accordance with regulations of the Cost Accounting Standards Board. The practices disclosed for this contract shall be the same as the practices currently disclosed and applied on all other contracts and subcontracts being performed by the

contractor and which contain this Cost Accounting Standards clause. If the contractor has marked the Disclosure Statement to indicate that it contains trade secrets and commercial or financial information which is privileged and confidential, the Disclosure Statement will be protected and will not be released outside of the Government.

(2) Follow consistently the cost accounting practices disclosed pursuant to (1) above in accumulating and reporting contract performance cost data concerning this contract. If any change in disclosed practices is made for purposes of any contract or subcontract subject to Cost Accounting Standards Board requirements, the change must be applied prospectively to this contract, and the Disclosure Statement must be amended accordingly. If the contract price or cost allowance of this contract is affected by such changes, adjustment shall be made in accordance with subparagraph (a)(4) or (a)(5) below, as appropriate.

(3) Comply with all Cost Accounting Standards in effect on the date of awards of this contract or if the contractor has submitted cost or pricing data, on the date of final agreement on price as shown on the contractor's signed certificate of current cost or pricing data. The contractor shall also comply with any Cost Accounting Standard which hereafter becomes applicable to a contract or subcontract of the contractor. Such compliance shall be required prospectively from the date of applicability to such contract or subcontract.

(4)(A) Agree to an equitable adjustment as provided in the changes clause of this contract if the contract cost is affected by a Disclosure Statement change which the contractor is required to make pursuant to (3) above. If the contractor has not been required to file a Disclosure Statement but is required pursuant to (a)(3) above to change an established practice, then an equitable adjustment shall similarly be agreed to.

(B) Negotiate with the contracting officer to determine the terms and conditions under which any Disclosure Statement change other than changes under (4)(A) above may be made. A change to a Disclosure Statement may be proposed by

either the Government or the contractor, provided, however, that no agreement may be made under this provision, that will increase costs paid by the United States under this contract.

(5) Agree to an adjustment of the contract price or cost allowance, as appropriate, if he or a subcontractor fails to comply with an applicable Cost Accounting Standard or to follow any practice disclosed pursuant to subparagraphs (a)(1) and (a)(2) above and such failure results in any increased costs paid by the United States. Such adjustment shall provide for recovery of the increased costs to the United States together with interest thereon computed at the rate determined by the Secretary of the Treasury pursuant to Public Law 92-41, 85 Stat. 97, or 7 percent per annum, whichever is less, from the time the payment by the United States was made to the time the adjustment is effected.

(b) If the parties fail to agree whether the contractor or a subcontractor has complied with an applicable Cost Accounting Standard, rule, or regulation of the Cost Accounting Standards Board and as to any cost adjustment demanded by the United States, such failure to agree shall be a dispute concerning a question of fact within the meaning of the disputes clause of this contract.

(c) The contractor shall permit any authorized representatives of the head of the agency, of the Cost Accounting Standards Board, or of the Comptroller General of the United States to examine and make copies of any documents, papers, or records relating to compliance with the requirements of this clause.

(d) The contractor shall include in all negotiated subcontracts which he enters into the substance of this clause except paragraph (b), and shall require such inclusion in all other subcontracts of any tier, except that this requirement shall apply only to negotiated subcontracts in excess of \$100,000 where the price negotiated is not based on:

- (i) Established catalog or market prices of commercial items sold in substantial quantities to the general public, or



- (ii) prices set by law or regulation.

**NOTE:** (1) Subcontractors shall be required to submit their Disclosure Statements to the Contractor. However, if a subcontractor has previously submitted his Disclosure Statement to a Government Administrative Contracting Officer (ACO) he may satisfy that requirement by certifying to the contractor the date of such Statement and the address of the ACO.

(2) In any case where a subcontractor determines that the Disclosure Statement information is privileged and confidential and declines to provide it to his contractor or higher tier subcontractor, the contractor may authorize direct submission of that subcontractor's Disclosure Statement to the same Government offices to which the contractor was required to make submission of his Disclosure Statement. Such authorization shall in no way relieve the contractor of liability as provided in paragraph (a)(5) of this clause. In view of the foregoing and since the contract may be subject to adjustment under this clause by reason of any failure to comply with rules, regulations, and Standards of the Cost Accounting Standards Board in connection with covered subcontracts, it is expected that the contractor may wish to include a clause in each such subcontract requiring the subcontractor to appropriately indemnify the contractor. However, the inclusion of such a clause and the terms thereof are matters for negotiation and agreement between the contractor and the subcontractor, provided that they do not conflict with the duties of the contractor under its contract with the Government. It is also expected that any subcontractor subject to such indemnification will generally require substantially similar indemnification to be submitted by his subcontractors.

(e) The terms defined in Sec. 331.2 of Part 331 of Title 4, Code of Federal Regulations (4 CFR 331.2) shall have the same meanings herein. As there defined, "negotiated subcontract" means "any subcontract except a firm fixed-price subcontract made by a contractor or subcontractor after receiving offers from at least two firms not associated with each other or such contractor or



subcontractor, providing (1) the solicitation to all competing firms is identical, (2) price is the only consideration in selecting the subcontractor from among the competing firms solicited, and (3) the lowest offer received in compliance with the solicitation from among those solicited is accepted."

(End of Clause)

7-204.53 - Add:

7-204.53 *Cost Accounting Standards*. In accordance with 3-1204, insert the clause set forth in 7-104.83.

Insert same sentence in:

7-303.53  
7-403.49  
7-603.52  
7-606.22  
7-608.4  
7-705.28  
7-902.35  
7-1702.17  
7-1903.48  
7-1910.35

15-109 - Add:

15-109 *Definitions*.

As used in this Section XV (except for Part 3), the words and phrases defined in this paragraph shall have the meanings set forth below.

(a) Profit Center - the smallest organizationally independent segment of a company which has been charged by management with profit and loss responsibilities.

(b) Accumulating Costs - The collecting of cost data in an organized manner, such as through a system of accounts.

(c) Actual Costs - Amounts determined on the basis of costs incurred, as distinguished from forecasted costs. Includes standard costs properly adjusted for applicable variances.

(d) **Allocate** - To assign an item of cost, or a group of items of cost, to one or more cost objectives. This term includes both direct assignment of cost and the reassignment of a share from an indirect cost pool.

(e) **Cost Objective** - A function, organizational subdivision, contract, or other work unit for which cost data are desired and for which provision is made to accumulate and measure the cost of processes, products, jobs, capitalized projects, etc.

(f) **Direct Cost** - Any cost which is identified specifically with a particular final cost objective. Direct costs are not limited to items which are incorporated in the end product as material or labor. Costs identified specifically with a contract are direct costs of that contract. All costs identified specifically with other final cost objectives of the contractor are direct costs of those cost objectives.

(g) **Estimating Costs** - The process of forecasting a future result in terms of cost, based upon information available at the time.

(h) **Final Cost Objective** - A cost objective which has allocated to it both direct and indirect costs, and, in the contractor's accumulation system, is one of the final accumulation points.

(i) **Indirect Cost** - Any cost not directly identified with a single final cost objective, but identified with two or more final cost objectives or with at least one intermediate cost objective.

(j) **Indirect Cost Pools** - Groupings of incurred costs identified with two or more cost objectives but not identified specifically with any final cost objective.

(k) **Pricing** - The process of establishing the amount or amounts to be paid in return for goods or services.

(l) **Proposal** - Any offer or other submission used as a basis for pricing a contract, contract modification, or termination settlement, or for securing payments thereunder.

(m) **Reporting Costs** - Provision of cost information to others. The reporting of costs involves selecting relevant cost data and presenting it in an intelligible manner for use by the recipient.

## 15-201.2 - Revise as follows:

**15-201.2 *Factors Affecting Allowability of Costs.*** Factors to be considered in determining the allowability of individual items of cost include (i) reasonableness, (ii) allocability, (iii) standards promulgated by the Cost Accounting Standards Board, if applicable, otherwise, generally accepted accounting principles and practices appropriate to the particular circumstances, and (iv) any limitations or exclusions set forth in this Part 2, or otherwise included in the contract as to types or amounts of cost items. (But see 15-201.3(b)(4).) When a contractor has disclosed his accounting practices in accordance with Cost Accounting Standards Board Rules, Regulations, and Standards and any such practices are inconsistent with any of the provisions of this Part 2, costs resulting from such inconsistent practices shall not be allowed in excess of the amount that would have resulted from the use of practices consistent with this Part 2.

## 15-201.4 - Revise as follows:

**15-201.4 *Definition of Allocability.*** A cost is allocable if it is assignable or chargeable to one or more cost objectives (see 15-109(e)) in accordance with the relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a Government contract if it —

- (i) is incurred specifically for the contract;
- (ii) benefits both the contract and other work, or both Government work and other work, and can be distributed to them in reasonable proportion to the benefits received; or
- (iii) is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.

## 15-202 - Revise as follows:

**15-202 - *Direct Costs.***

(a) A direct cost is any cost which is identified specifically with a particular final cost objective. (See 15-109(f).) No final cost objective shall have allocated to it as a direct cost any

cost, if other costs incurred for the same purpose, in like circumstances, have been included in any indirect cost pool to be allocated to that or any other final cost objective. Costs identified specifically with the contract are direct costs of the contract and are to be charged directly thereto. Costs identified specifically with other final cost objectives of the contractor are direct costs of those cost objectives and are not to be charged to the contract directly or indirectly.

(b) Any direct cost of minor dollar amount may be treated as an indirect cost for reasons of practicality where the accounting treatment for such cost is consistently applied to all final cost objectives, provided that such treatment produces results which are substantially the same as the results which would have been obtained if such costs had been treated as a direct cost.

15-203 - Revise as follows:

15-203 *Indirect Costs.*

(a) An indirect cost (see 15-109(i)) is one which, because of its incurrence for common or joint objectives, is not readily subject to treatment as a direct cost. Any direct cost of minor dollar amount may be treated as an indirect cost for reasons of practicality under the circumstances set forth in 15-202(b). After direct costs have been determined and charged directly to the contract or other work as appropriate, indirect costs are those remaining to be allocated to the several cost objectives. No final cost objective shall have allocated to it as an indirect cost any cost, if other costs incurred for the same purpose, in like circumstances, have been included as a direct cost of that or any other final cost objective.

(b) No change.

(c) No change.

(d) The method of allocation of indirect costs must be based on the particular circumstances involved. The method shall be in accordance with Standards promulgated by the Cost Accounting Standards Board, if applicable to the contract. Otherwise, the method shall be in accordance with generally accepted accounting principles. When Cost

Accounting Standards Board Standards are not applicable to the contract, the contractor's established practices, if in accordance with generally acceptable accounting principles, shall generally be acceptable. However, the method used by the contractor may require examination when —

(i) through (iii) - No change.

(e) No change.

(f) No change.

**APPENDIX O**  
**CODE OF FEDERAL REGULATIONS**  
**TITLE 4 — ACCOUNTS**  
**CHAPTER III - COST ACCOUNTING**  
**STANDARDS BOARD**  
**COST ACCOUNTING STANDARDS, RULES,**  
**AND REGULATIONS**  
**Subchapter C — Procurement Practices**  
**Part 331 — CONTRACT COVERAGE**

Sec.

- 331.1 Purpose and Scope
- 331.2 Definitions
- 331.3 Applicability
- 331.4 Solicitation Notice
- 331.5 Contract Clause
- 331.6 Post-Award Disclosure
- 331.7 Interpretation
- 331.8 Effective Date

**Authority:** The provisions of this Part 331 are issued under 84 Stat. 796, Sec. 103; 50 U.S.C. App. 2168.

**331.1 Purpose and Scope.**

The regulations contained in this part are promulgated to implement the Standards and the rules and regulations established by the Cost Accounting Standards Board pursuant to 50 U.S.C. App. 2168 (Public Law 91-379, August 15, 1970). The requirements set forth herein shall be binding upon all relevant Federal agencies and upon defense contractors and subcontractors.

**331.2 Definitions.**

(a) A "relevant Federal agency" is any Federal agency making a national defense procurement and any agency whose responsibilities include review, approval, or other action affecting such a procurement.

(b) A "defense contractor" is any contractor entering into a contract with the United States for the production of material or the performance of services for the national defense.



(c) A "defense subcontractor" is any person other than the United States who contracts, at any tier, to perform any part of a defense contractor's contract.

(d) "National defense" is any program for military and atomic energy production or construction, military assistance to any foreign nations, stockpiling, space, and directly related activity.

(e) The definition of "established catalog or market prices of commercial items sold in substantial quantities to the general public" set out in the Armed Services Procurement Regulation, Section 3-807.1(b) (32 C.F.R. 3.807-1(b)), in effect at the date of the contract, shall be used.

(f) A "negotiated subcontract" is any subcontract except a firm fixed-price subcontract made by a contractor or subcontractor after receiving offers from at least two firms not associated with each other or such contractor or subcontractor, providing (1) the solicitation to all competing firms is identical, (2) price is the only consideration in selecting the subcontractor from among the competing firms solicited, and (3) the lowest offer received in compliance with the solicitation from among those solicited is accepted.

(g) A "Disclosure Statement" is the Disclosure Statement required by Cost Accounting Standards Board regulation (4 C.F.R., Part 351).

### 331.3 Applicability.

The head of each relevant Federal agency shall cause or require the clause set forth in Section 331.5 hereof and captioned COST ACCOUNTING STANDARDS to be inserted in all negotiated defense contracts in excess of \$100,000, other than contracts entered into by the agency where the price is based on: (a) established catalog or market prices of commercial items sold in substantial quantities to the general public, or (b) prices set by law or regulation. Additionally, all solicitations, likely to result in a contract in which the clause set forth in Section 331.5 hereof must be inserted, shall include the notice set forth in Section 331.4 hereof and captioned DISCLOSURE STATEMENT-COST ACCOUNTING PRACTICES AND CERTIFICATION.

## 331.4 Solicitation Notice.

**DISCLOSURE STATEMENT — COST  
ACCOUNTING PRACTICES AND  
CERTIFICATION**

Any contract in excess of \$100,000 resulting from this solicitation, except contracts where the price negotiated is based on (1) established catalog or market prices of commercial items sold in substantial quantities to the general public, or (2) prices set by law or regulation, will be subject to the requirements of the Cost Accounting Standards Board. Any offeror submitting a proposal, which, if accepted, will result in a contract subject to the requirements of the Cost Accounting Standards Board, must, as a condition of contracting, submit a Disclosure Statement as required by regulations of the Board. The Disclosure Statement must be submitted as a part of the offeror's proposal under this solicitation unless, in compliance with agency procedures, the offeror has already submitted a Disclosure Statement disclosing the practices used in connection with the pricing of this proposal, or unless post-award submission has been authorized by the Contracting Officer in accordance with regulations of the Cost Accounting Standards Board (see 4 C.F.R. 331.7). If an applicable Disclosure Statement has already been submitted, the offeror may satisfy the requirement for submission by providing the following information:

**CERTIFICATION (APPLICABLE  
ONLY TO PROPOSALS RESULTING  
IN CONTRACTS SUBJECT TO COST  
ACCOUNTING STANDARDS BOARD  
REQUIREMENTS)**

By submission of this offer, the offeror certifies that his practices used in estimating costs in pricing this proposal are consistent with the cost accounting practices disclosed in the applicable Disclosure Statement.

331.5 Contract Clause.

The following clause shall be inserted in all contracts subject to Cost Accounting Standards Board requirements:

**COST ACCOUNTING STANDARDS**

(a) Unless the Cost Accounting Standards Board has prescribed rules or regulations exempting the contractor or this contract from Standards, rules, and regulations promulgated pursuant to 50 U.S.C. App. 2168 (Public Law 91-379, August 15, 1970), the contractor, in connection with this contract shall:

(1) By submission of a Disclosure Statement, disclose in writing his cost accounting practices as required by regulations of the Cost Accounting Standards Board. The required disclosures must be made prior to contract award unless the Contracting Officer provides a written notice to the contractor authorizing post-award submission in accordance with regulations of the Cost Accounting Standards Board. The practices disclosed for this contract shall be the same as the practices currently disclosed and applied on all other contracts and subcontracts being performed by the contractor and which contain this COST ACCOUNTING STANDARDS clause. If the contractor has notified the Contracting Officer that the Disclosure Statement contains trade secrets and commercial or financial information which is privileged and confidential, the Disclosure Statement will be protected and will not be released outside the Government.

(2) Follow consistently the cost accounting practices disclosed pursuant to (1) above in accumulating and reporting contract performance cost data concerning this contract. If any change in disclosed practices is made for purposes of any contract or subcontract subject to Cost Accounting Standards Board requirements, the change must be applied prospectively to this contract, and the Disclosure Statement must be amended accordingly. If the contract price or cost allowance of this contract is affected by such changes, adjustment shall be made in accordance with subparagraph (a)(4) or (a)(5) below, as appropriate.

(3) Comply with all Cost Accounting Standards in effect on the date of award of this contract or if the contractor has submitted cost or pricing data, on the date of final agreement on price as shown on the contractor's signed certificate of current cost or pricing data. The contractor shall also comply with any Cost Accounting Standard which hereafter becomes applicable to a contract or subcontract of the contractor. Such compliance shall be required prospectively from the date of applicability to such contract or subcontract.

(4)(A) Agree to an equitable adjustment as provided in the changes clause of this contract if the contract cost is affected by a Disclosure Statement change which the contractor is required to make pursuant to (a)(3) above. If the contractor has not been required to file a Disclosure Statement but is required pursuant to (a)(3) above to change an established practice, then an equitable adjustment shall similarly be agreed to.

(B) Negotiate with the contracting officer to determine the terms and conditions under which any Disclosure Statement change other than changes under (4)(A) above may be made. A change to a Disclosure Statement may be proposed by either the Government or the contractor, provided, however, that no agreement may be made under this provision, that will increase costs paid by the United States under this contract.

(5) Agree to an adjustment of the contract price or cost allowance, as appropriate, if he or a subcontractor fails to comply with an applicable Cost Accounting Standard or to follow any practice disclosed pursuant to subparagraphs (a)(1) and (a)(2) above and such failure results in any increased costs paid by the United States. Such adjustment shall provide for recovery of the increased costs to the United States together with interest thereon computed at the rate determined by the Secretary of the Treasury pursuant to Public Law 92-41, 85 Stat. 97, or 7 percent per annum, whichever is less, from the time the payment by the United States was made to the time the adjustment is effected.

(b) If the parties fail to agree whether the contractor or a subcontractor has complied with an applicable Cost Accounting Standard, rule, or regulation of the Cost Accounting Standards Board and as to any cost adjustment demanded by the United States, such failure to agree shall be a dispute concerning a question of fact within the meaning of the disputes clause of this contract.

(c) The contractor shall permit any authorized representative of the head of the agency, of the Cost Accounting Standards Board, or of the Comptroller General of the United States to examine and make copies of any documents, papers, or records relating to compliance with the requirements of this clause.

(d) The contractor shall include in all negotiated subcontracts which he enters into the substance of this clause except paragraph (b) and shall require such inclusion in all other subcontracts of any tier, except that this requirement shall apply only to negotiated subcontracts in excess of \$100,000 where the price negotiated is not based on:

(i) Established catalog or market prices of commercial items sold in substantial quantities to the general public, or

(ii) Prices set by law or regulation.

However, if this is a contract with an agency which permits subcontractors to appeal final decisions of the contracting officer directly to the head of the agency or his duly authorized representative, then the contractor shall include the substance of paragraph (b) as well.

NOTE: In any case where a subcontractor determines that the Disclosure Statement information is privileged and confidential and declines to provide it to his contractor or higher tier subcontractor, the contractor may authorize direct submission of that subcontractor's Disclosure Statement to the same Government offices to which the contractor was required to make submission of his Disclosure Statement. Such authorization shall in no way relieve the contractor of liability as provided in paragraph (a)(5) of this clause. In view



of the foregoing and since the contract may be subject to adjustment under this clause by reason of any failure to comply with rules, regulations, and Standards of the Cost Accounting Standards Board in connection with covered subcontracts, it is expected that the contractor may wish to include a clause in each such subcontract requiring the subcontractor to appropriately indemnify the contractor. However, the inclusion of such a clause and the terms thereof are matters for negotiation and agreement between the contractor and the subcontractor, provided that they do not conflict with the duties of the contractor under its contract with the Government. It is also expected that any subcontractor subject to such indemnification will generally require substantially similar indemnification to be submitted by his subcontractors.

(e) The terms defined in Section 331.2 of Part 331 of Title 4, Code of Federal Regulations (4 C.F.R. 331.2) shall have the same meaning herein. As there defined, "negotiated subcontract" means "any subcontract except a firm fixed-price subcontract made by a contractor or subcontractor after receiving offers from at least two firms not associated with each other or such contractor or subcontractor, providing (1) the solicitation to all competing firms is identical, (2) price is the only consideration in selecting the subcontractor from among the competing firms solicited, and (3) the lowest offer received in compliance with the solicitation from among those solicited is accepted."

#### **331.6 Post-Award Disclosure.**

(a) As specified in the solicitation notice and contract clause set forth in Section 331.5, Disclosure Statements must be submitted by offerors required to make disclosure prior to contract award unless the contracting officer authorizes in writing post-award submission. As specified in the contract clause set forth in Section 331.5, Disclosure Statements must be submitted by prospective subcontractors required to make disclosure prior to subcontract award unless the contracting officer at the request of the contractor authorizes in writing post-award submission.



(b) Post-award submission may be authorized only when the contracting officer has made a written determination that such authorization is essential (1) to the national defense, (2) because of the public exigency, or (3) to avoid undue hardship. Each determination shall set forth facts which clearly support the determination to authorize post-award submission, and a copy of the determination shall be included in the contract file. Authorization issued pursuant to this paragraph shall specify the time, not to exceed 90 days after contract or subcontract award, by which disclosure must be made.

(c) In the event the agency head determines that it is impractical to secure [sic] a required Disclosure Statement in accordance with the contract clause and this section, he may authorize award of such contract or subcontract. He shall within 30 days thereafter submit a report to the Cost Accounting Standards Board, setting forth all material facts. The authority in this section 331.6(c) shall not be delegated.

### 331.7 Interpretation.

(a) Increased costs paid by the United States as referred to in paragraph (a)(5) of the COST ACCOUNTING STANDARDS clause shall be deemed to have resulted whenever the cost paid by the Government results from application of practices other than the contractor's disclosed practices or from failure to comply with applicable Cost Accounting Standards, and such cost is higher than it would have been had the disclosed practices been followed or applicable Cost Accounting Standards been complied with.

(b) In negotiated firm fixed-price type contracts, however, "increased costs" cannot be interpreted in terms of a higher level of costs reimbursed during contract performance, since in such contracts the price to be paid would normally be the price agreed to. That price will have been based on the requirement that the contractor use his disclosed practices and comply with applicable Cost Accounting Standards. Subsequently, if the contractor fails during contract performance to follow his disclosed practices or to comply with applicable Cost Accounting Standards, any increased cost to the United States by reason of that

failure must be measured by the difference between the cost estimates used in negotiations and the cost estimates that would have been used had the contractor proposed on the basis of the practices actually used during contract performance. (In cases where an off-set of decreased costs allocated to firm fixed-price contracts against increased costs allocated to cost reimbursement type contract may be involved, the provisions of subparagraph (f) hereof shall apply.)

(c) The statutory requirement underlying this interpretation is that the United States not pay increased costs, including a profit enlarged beyond that in the contemplation of the parties to the contract when the contract costs, price, or profit is negotiated, by reason of a contractor's failure to use applicable Cost Accounting Standards or to follow his disclosed practices. In making price adjustments under paragraph (a)(5) of the COST ACCOUNTING STANDARDS clause, in fixed-price or cost-reimbursement incentive contracts, or contracts providing for prospective or retroactive price redetermination, the Federal agency shall apply this requirement appropriately in the circumstances.

(d) The contractor and the contracting officer may enter into an agreement as contemplated by paragraph (a)(4)(B) of the COST ACCOUNTING STANDARDS clause, covering a change in practice proposed by the Government or the contractor for all of the contractor's contracts for which the contracting officer is responsible, provided that the agreement does not permit any increase in the cost paid by the Government. Such agreement may be made final and binding, notwithstanding the fact that experience may subsequently establish that the actual impact [sic] of the change differed from that agreed to.

(e) To facilitate agreements with a contractor who has a large number of contracts affected by a proposed change in his disclosed cost accounting practices or affected by application of Cost Accounting Standards, contracting agencies are urged to establish procedures under which the contractor may seek, and in proper cases obtain, agreement with a single official concerning the impact of the proposed

change or application of Standards upon all such contracts of that agency.

(f) In one circumstance an adjustment to the contract price or of cost allowances pursuant to paragraph (a)(4)(B) of the Cost Accounting Standards clause may not be required when an amendment to disclosed practices is estimated to result in increased costs being paid under a particular contract by the United States. This circumstance may arise when a contractor is performing two or more contracts, subject to Cost Accounting Standards Board rules, regulations, and Standards, with an agency or agencies of the United States, and when he proposes to change a practice disclosed for all such contracts. The amendment may increase the cost paid under one or more of the contracts, while decreasing the cost paid under one or more of the contracts. In such case, the Government will not pursuant to paragraph (a)(4)(B) require price adjustment for any increased costs paid by the United States so long as the costs decreased under one or more contracts are at least equal to the increased cost under the other affected contracts, provided that the contractor and all affected contracting officers agree on the method by which the price adjustments are to be made for all affected contracts. In this situation, the contracting agencies would, of course, require an adjustment of the contract price or cost allowances, as appropriate, to the extent that the increases under certain contracts were not offset by the decreases under the remaining contracts.

(g) Where, through inadvertence, the contractor has failed to use applicable Cost Accounting Standards or to follow his disclosed practices and has not notified his contracting officer or officers of that failure, if the result of that failure is to increase costs paid under one or more contracts, while decreasing costs paid under one or more contracts, the contracting officer or officers of the agency or agencies concerned are urged, in the interest of administrative convenience, to negotiate the adjustment of the contract prices or cost allowances, as appropriate, of the affected contracts by requiring repayment of only the difference between the

estimated price increases and the estimated price decreases, together with any applicable interest.

### 331.8 Effective Date.

The Disclosure Statement requirement at Section 331.4 (4 C.F.R. 331.4) shall be included in all applicable solicitations issued on or after July 1, 1972, and all resulting contracts shall contain the contract clause at Section 331.5 of this part (4 C.F.R. 331.5). In any event, any other contract which is within the jurisdiction of the Cost Accounting Standards Board and which is awarded on or after October 1, 1972, shall contain that contract clause. Relevant Federal agencies shall notify the Cost Accounting Standards Board not later than June 1, 1972, of the action taken to implement this regulation.

## Subchapter E—Disclosure Statement PART 351—BASIC REQUIREMENTS

### Sec.

- 351.1 (Reserved)
- 351.2 Purpose.
- 351.3 Definitions.
- 351.4 Filing Requirements.
- 351.5 Contract Awards.
- 351.6 Forms.
- 351.7 Submission.
- 351.8 Incorporation of Disclosure Statement.
- 351.9 Adequacy of Disclosure Statement.
- 351.10 Effect of Filing Disclosure Statement.
- 351.11 Early Filing.
- 351.12 Amendment of Disclosure Statement.
- 351.13 Instructions and Information.
- 351.14 Disclosure Statement.

Authority: The provisions of this Part 351 are issued under 84 Stat. 796, Sec. 103; 50 U.S.C. App. 2168.